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"...one in a million"



The 95th Annual Meeting of AT&T shareholders will be held at 2:00 p.m. on Wednesday, April 16, 1980, in the John B. Hynes Veterans Auditorium, 900 Boylston Street, Boston, Massachusetts.

The consolidated financial results reported herein are for American Telephone and Telegraph Company and its subsidiaries.

If you wish further information, the following are available upon request:

- 1979 Statistical Report, with additional data on our operations.
- Form 10-K, AT&T's annual report to the Securities and Exchange Commission.
- Annual reports of the Bell telephone operating companies, the Western Electric Company and Bell Laboratories.
- Information relating to various Bell System benefit plans for employees contained in plan descriptions, annual reports and other materials regularly made available to employees under the Employee Retirement Income Security Act of 1974.

The AT&T Annual Report is also available in braille, talking records and cassettes.

Address requests to the Secretary, American Telephone and Telegraph Company, 195 Broadway, New York, N.Y. 10007. The telephone number of the Company is 212-393-9800.

Information on AT&T common and preferred stock, bonds, dividends or interest payments and the Dividend Reinvestment and Stock Purchase Plan can be obtained by calling without charge 800-631-3311 or, from New Jersey, 800-352-4900. Mailed inquiries should be addressed to AT&T Co., P.O. Box 2018, New Brunswick, N.J. 08903.

The Company maintains stock transfer offices at 180 Fulton St., New York, N.Y. 10007; at 444 Hoes Lane, Piscataway, N.J. 08854, both of which can be reached through the toll-free telephone numbers above, and at 140 New Montgomery St., San Francisco, Calif. 94105, which office can be reached by calling 415-542-3801.

ON THE COVER: Hal Morris of Mountain Bell in Salt Lake City is one of the hundred employees whose pictures illustrate this annual report. They were randomly selected from the Bell System's total work force of more than a million. Each makes a unique contribution to the business; each is "one in a million." In return, Bell System management recognizes its basic obligation—as set forth in "Words We Live By," a statement of policy first published in the 1977 Annual Report—to "provide our employees, regardless of their number, a job in an organization where they are known and respected as individuals, where their voices can be heard and their work appreciated."



Highlights	1979	1978
Earnings per share	\$ 8.04	\$ 7.74
Dividends declared per common share	\$ 5.00	\$ 4.60
Revenues including other income (millions)	\$46,183	\$41,744
Expenses including taxes and interest (millions)	\$40,509	\$36,471
Net income (millions)	\$ 5,674	\$ 5,273
Rate of return on average total capital	9.8%	9.7%

THE BELL SYSTEM The principal business of the Bell System is communications. More particularly, it is the role of the Bell telephone companies to provide communications services to and among individuals and institutions in those sectors of the United States that they are franchised to serve and to provide as well for connection with other United States telephone companies and telephone systems throughout the world. With the Independent telephone companies, they operate an integrated nationwide network of facilities which at the user's command can transfer information in virtually any form—voice, data, graphics—between appropriately equipped terminals virtually anywhere in the United States. To fulfill—and to enhance continuously its ability to fulfill—these functions, the Bell System conducts extensive research and development activities at Bell Laboratories and manufacturing operations at Western

Electric. Of the Bell System's 21 principal operating telephone companies, all but four are wholly owned by AT&T: Pacific Telephone (89.8%), Pacific Northwest Bell (89.4%), Mountain Bell (88.6%) and New England Telephone (86%). In addition, AT&T has a noncontrolling ownership in Cincinnati Bell (28.7%) and Southern New England Telephone (19.9%). The Western Electric Company, a wholly owned subsidiary, manufactures and purchases telecommunications products and supplies for the Bell System; Bell Laboratories, jointly owned by AT&T and Western Electric, provides research and development services. AT&T's Long Lines Department has responsibility for overall management of the nationwide telecommunications network and for connection of the network, via underseas cable and satellite, with telecommunications systems throughout the world. The major Bell System units are listed below.

American Telephone and Telegraph Company	195 Broadway, New York, New York 10007
American Telephone and Telegraph Company Long Lines Department	Bedminster, New Jersey 07921
New England Telephone and Telegraph Company	185 Franklin Street, Boston, Massachusetts 02107
The Southern New England Telephone Company	227 Church Street, New Haven, Connecticut 06506
New York Telephone Company	1095 Avenue of the Americas, New York, New York 10036
New Jersey Bell Telephone Company	540 Broad Street, Newark, New Jersey 07101
The Bell Telephone Company of Pennsylvania	One Parkway, Philadelphia, Pennsylvania 19102
The Diamond State Telephone Company	One Parkway, Philadelphia, Pennsylvania 19102
The Chesapeake and Potomac Telephone Company	930 H Street, N.W., Washington, D.C. 20001
The Chesapeake and Potomac Telephone Company of Maryland	Constellation Place, 1 East Pratt Street, Baltimore, Maryland 21202
The Chesapeake and Potomac Telephone Company of Virginia	703 East Grace Street, Richmond, Virginia 23219
The Chesapeake and Potomac Telephone Company of West Virginia	1500 MacCorkle Avenue, S.E., Charleston, West Virginia 25314
Southern Bell Telephone and Telegraph Company	Hurt Building, P.O. Box 2211, Atlanta, Georgia 30301
South Central Bell Telephone Company	600 North 19th Street, Birmingham, Alabama 35203
The Ohio Bell Telephone Company	100 Erieview Plaza, Cleveland, Ohio 44114
Cincinnati Bell Inc.	225 East Fourth Street, P.O. Box 2301, Cincinnati, Ohio 45201
Michigan Bell Telephone Company	444 Michigan Avenue, Detroit, Michigan 48226
Indiana Bell Telephone Company, Incorporated	240 North Meridian Street, Indianapolis, Indiana 46204
Wisconsin Telephone Company	722 North Broadway, Milwaukee, Wisconsin 53202
Illinois Bell Telephone Company	225 West Randolph Street, Chicago, Illinois 60606
Northwestern Bell Telephone Company	100 South Nineteenth Street, Omaha, Nebraska 68102
Southwestern Bell Telephone Company	1010 Pine Street, St. Louis, Missouri 63101
The Mountain States Telephone and Telegraph Company	931 Fourteenth Street, Denver, Colorado 80202
Pacific Northwest Bell Telephone Company	Sixteen Hundred Bell Plaza, Seattle, Washington 98191
The Pacific Telephone and Telegraph Company (including Bell Telephone Company of Nevada)	140 New Montgomery Street, San Francisco, California 94105
Western Electric Company, Incorporated	222 Broadway, New York, New York 10038
Bell Telephone Laboratories, Incorporated	600 Mountain Avenue, Murray Hill, New Jersey 07974

Report of the Chairman of the Board

Dear Share Owner:

The growth in demand for the Bell System's services continued strong throughout 1979 in the face of an uncertain economy and disturbingly high rates of inflation. Whether a recession had actually begun continued to be debated at year's end. Our own perception is that economic activity peaked in the Spring and since then has slowly declined.

Nonetheless for the year as a whole, we handled a volume of business 9.7 per cent larger than in 1978. Revenues increased 10.8 per cent and income applicable to AT&T common shares by eight per cent.

I can best convey the significance of the Bell System's 1979 performance in the context of three priorities that a year ago at the outset of my term as Chairman I said would guide my conduct of the business. The first was to enhance the Bell System's earnings and service capabilities. We have done that.

Earnings

Earnings per share from operations were \$8.04 compared to \$7.74 in 1978. These are altogether creditable results considering the state of the economy. However, they fall somewhat short of what I hoped I might report in this my first Annual Report to share owners. I believe we can do better—and will.

Early in the year, the board of directors increased the quarterly

dividend to \$1.25. This was the thirteenth increase in the dividend since 1958. Since then dividend increases have kept pace with the increase in the cost of living. We are proud of what we have been able to accomplish in this regard—and certainly maintaining the integrity of the dividend over the long haul remains a keystone of our financial policy. That will be difficult to do in the face of inflation of the virulence we've experienced over the past year. That's because our rates are regulated, our costs aren't—and consequently the repricing that other businesses undertake at will we can do only after intensive and often protracted regulatory proceedings.

It is for this reason that I have observed that any credible—and sustained—program to curb inflation has got to be good news for the Bell System in the long run. It is in this perspective that I view the Federal Reserve Board's current approach to the control of the growth in the money supply and the tightening of credit we've experienced since it was initiated last October. Upon the announcement of that program, the price of AT&T shares—along with the prices of other so-called "interest-sensitive" companies—declined sharply, doubtless reflecting the views of many investors that we would be required to pay significantly higher rates for the new money we need to finance construction.

And indeed we have. The interest cost on the Bell System's short term obligations at the end of the year was 310 basis points higher than at the end of 1978. And the 11.35 per cent interest cost on Mountain Bell's late October offer of \$175 million in long term debentures was a record high, since exceeded, for triple-A Bell System securities. At the end of the year, the average interest cost of all outstanding long and intermediate term Bell System debt was some 30 basis points higher than it was at the end of 1978.

Regrettably 1979 saw a pause in the good progress we've made in recent years in reducing the propor-

tion of debt in our capital structure toward the 40 to 45 per cent range that seems to us about right for our business. Indeed, at year's end the Company's debt ratio declined but marginally—46.4 per cent versus 46.5 per cent—and would, in fact, have risen had it not been for the issuance of \$1.7 billion in common equity to share owners participating in our Dividend Reinvestment and Stock Purchase Plan and to employees participating in Company-sponsored savings and stock ownership plans.

At year's end, as they had for some months, the Company's shares were selling below their book value—one evidence that the pace of our earnings improvement falls short of investor expectations in today's economic environment. We have told the Federal Communications Commission that—as a consequence of inflation's influence on investor expectations—we need to earn no less than 12 per cent on the capital devoted to interstate services to assure sound financing of service growth and improvement.

In 1979 the Bell System's return on average total capital was 9.8 per cent compared to 9.7 per cent in 1978. Clearly inflation has outpaced even our redoubled efforts to improve productivity and consequently we must continue to press for rates that will produce a higher return. This we are doing in every jurisdiction where earnings fall short of the level that fairness to our share owners and the needs of the future demand. And we do so without apology. Over the past 10 years telephone rates have risen less than half the increase in the Consumer Price Index—this as a consequence of our own efforts to improve efficiency through advances in technology and operating methods.

Service

By conventional measures—our own technical indices and what our customers tell us about their experience of it—we delivered a good grade of service in 1979. Of perhaps

more significance, however, was the enhanced capability we built into the telephone network in the course of the year. With each passing year we are accelerating the transformation of a network that not so long ago provided a more or less uniform service to all its customers to one that not many years hence will serve no two of them alike. The following pages are a record of the year's progress toward matching our services—in quality and kind—not only to the diverse needs of the society we serve but to the unique needs of every member of that society.

Restructuring

Nineteen seventy-nine was a year of progress toward fulfillment of the second of the three priorities I stated a year ago—to accomplish those changes in the Bell System's structure and practices that will assure our ability to fulfill the opportunities of the Information Age that is so largely the product of our own technology. Indeed, 1979 may well be remembered as a turning point in the Bell System's history. In the course of the year we completed, albeit variously in each of the associated companies, a fundamental restructuring of our business. It has been called—accurately, I believe—the most massive reorganization in the history of U.S. industry. There is no question in my mind that this restructuring is not only desirable but necessary. So large a change, of course, is not accomplished without cost. However, most of the start-up costs of restructuring are behind us now and I am convinced that by matching our organization to the markets we serve we are readier now to respond alertly to the future's demands than we were when 1979 began.

Toward Consensus

My third priority was—and is—to forward to the extent I can some kind of reasonable consensus as to what the ground rules for the telecommunications industry in this country ought to be.

As this is written, telecommunications legislation is under active development in the communications subcommittees of both Houses of Congress. What final form this legislation will take and when it might come to a vote are beyond prediction at this juncture. What is certain, however, is that the past year has seen much progress toward the consensus on national telecommunications policy that our industry needs and the nation needs.

For our part, we have worked hard to find ways to make competition work where it makes sense. To this end, we have indicated a readiness to undertake a further restructuring of our business that would separate our regulated services from unregulated services, thereby removing the occasion for competitors' concerns about cross subsidy between them.

By the same token, we have conveyed the depth of our own concerns. Among them, three are crucial. First is the need to preserve unitary management of a network that—to work as one—must be engineered and operated as one. Second is the need for mechanisms to deal with the problems of transition to a competitive environment, most particularly to cope with the very substantial shift of revenue requirements that developing competition in intercity calling will require. Our third concern is the need—in an era of rapidly developing competition—to free the Bell System from the constraints of the 1956 Consent Decree. No longer does it make sense to deny the Bell System the oppor-

tunity to compete in unregulated markets.

Clearly the ground rules for our industry require updating. This is why I continue to believe that legislation is necessary. What is more, I believe that sensible legislation, balancing all interests, is feasible. And I remain as committed as ever to its prompt development.

A Vital Future

From the foregoing, it might be concluded that the Bell System's only certain prospect is change. Not since its beginning has the future of this more than a century old business been less predictable than it is now—or more open to new possibilities. If we confront new dimensions of risk, we confront new dimensions of opportunity, too. This ferment of change I see as evidence of the undiminished vitality of a great enterprise. And I look forward to its outcome with confidence.

One reason I do so is because of what I know about the character of the Bell System. What makes the character of a company? Its people. In the following pages you will meet one hundred of the Bell System's people. Chosen at random from our entire employee population, they can be said to be representative of all million or so of us. But, as you will come to see, each is unique as a person and in his or her contribution to the business. Meeting them, you will, I hope, come to know the range of their skills, the depth of their commitment to doing a good job and why I am proud to be one of them.



A handwritten signature in dark ink, appearing to read 'C. L. Brown'.

C. L. BROWN

February 8, 1980



The Bell System in 1979

THE 100 PEOPLE whose pictures appear on this and the following pages were chosen at random—by computer—from among the more than one million employees of the Bell System. They work in switching centers and offices, laboratories and factories, service centers and PhoneCenter Stores from coast to coast and border to border. Some have jobs in crowded cities, some in crossroads villages. They include 54 men, 46 women; their average age is 39, their average service 15 years—figures that compare closely to the statistics for the Bell System as a whole. These hundred people tell us much about the million who work in Bell companies—the variety of their skills, the way those skills are deployed both geographically and structurally, the range of their personal interests and accomplishments. But no one of them is typical. Each is truly “one in a million” and makes a unique contribution to the Bell System’s job—matching technology to the needs of customers. That job begins in Bell Laboratories where Peter Morgan (left) works as a designer of digital transmission equipment.

The Bell System in 1979 handled 190 billion messages, added five million telephones for a total of 138 million in service and spent 15.8 billion capital dollars largely to expand and enhance the capabilities of the telecommunications network.

Growth in demand for service remained strong, despite some slowing in the second half of the year. Volume of business (revenues adjusted for changes in rates) increased 9.7 per cent. Long distance calling rose 10.8 per cent from 1978. International calls grew 20 per cent.

Operating revenues increased 10.8 per cent. Despite continuing efforts to control costs, operating expenses, fueled by inflation, rose 14 per cent. As a result, the Company showed only a modest improvement in its rate of earnings on average capital—9.8 per cent compared to 9.7 per cent in 1978.

Of the Company’s \$45.4 billion in revenues, some 37 per cent came from basic monthly rates and equipment charges to business and residence customers, 6.5 per cent from local message charges. Long distance calls, both state and interstate, accounted for 40 per cent. Most of the balance stemmed from Wide Area Telecommunications Service (WATS) and private line services for business and government and directory advertising. WATS revenues grew significantly, increasing some 16 per cent in 1979.

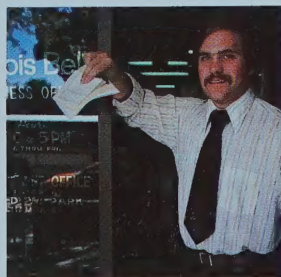
The quality of Bell System service remained high in 1979. More than 2.5 million customers were sur-

veyed in 1979. The vast majority expressed satisfaction with their service. We also report on service quality to the Federal Communications Commission (FCC) on a regular basis. Out of a potential 5,600 service shortcomings or “weakspots,” the Bell System had but 66 in 1979.

The Bell System spent \$15.8 billion for construction in 1979, \$2.2 billion more than in 1978. While we spend huge sums of capital each year to meet growing customer needs and to improve service, much of the year-to-year increase stems from inflation. In terms of constant dollars, the level of construction expenditures in recent years has remained relatively stable largely as a result of new technology that increases the efficiency of our facilities and of close management of capital projects.

Of our 1979 construction budget, 53 per cent was spent to meet current and anticipated growth. Twenty-three per cent was spent to replace older equipment and facilities with new technology. The balance largely involved capital expenditures for rearrangement of facilities and provision for customer movement.

Some \$2.4 billion or 16 per cent of our capital expenditures was for new electronic switching equipment. During the year we installed 350 local electronic central offices to serve 8.1 million lines, 23 per cent more lines than in 1978. At year’s end, 1,950 local electronic switching offices were serving some 37 per cent of the Bell System’s customers.



ROBERT ALEXANDER joined Illinois Bell a year ago as a service representative in the Company’s Champaign residence service center. Although he enjoys helping customers select the best possible service for their homes, Bob grew up wanting to climb telephone poles and hopes someday to work outside placing cable or installing phones.



WILLIAM APPLE has been a directory assistance operator for Southwestern Bell in St. Charles, Missouri, since early 1979. Bill’s wife, sister and brother-in-law work for the Company, too, and after hours they work together in Bill’s band.



ROBERT BARBER coordinates objectives and budgets, methods and procedures for a New England Telephone business division in Waltham, Massachusetts. Bob joined the Company more than 34 years ago at the urging of his uncle, an employee. Bob has since urged his daughter to do the same. She’s now an engineering clerk.



JOHN BECKOM is an assistant buyer with Western Electric’s purchasing department in Richmond, Virginia. During his 32 years with the Company, he has been awarded more than 50 certificates of recognition for cost reductions totaling \$10 million. John’s wife Frances also worked for Western and retired last October from her job in Richmond.



THELMA BELL has been an operator for Bell of Pennsylvania in Philadelphia for the past three years. She operates an electronic Traffic Service Position to help customers place their calls. Her mother is an operator in the same office. Thelma has a 10-year-old daughter who’s a budding dancer.

Fifteen long distance electronic switching systems were installed during the year. These large digital switchers can handle more than 500,000 calls an hour—more than four times the capacity of earlier systems. They also take less space and require far less maintenance. By the end of 1979, we had 35 in service.

Another technological advance being threaded through the network is a high-speed signaling system that enables switching centers to communicate rapidly with one another to establish availability of circuits, set up calling paths and collect information for billing. The signaling system means faster completion of calls and improved ability to route calls to avoid congestion within the network. More than 100 long distance switching centers are now using this signaling system.

Additional computerized operator consoles were also installed throughout the network. Called Traffic Service Position Systems (TSPS), they reduce operator time on collect, credit card and other special calls and mean faster, more efficient service. About 87 per cent of Bell System customers are now served by TSPS. In many locations these systems also are equipped to handle coin calls almost entirely by computer. They calculate the charges, announce them to the customer and count the coins deposited. By the end of 1980, two out of three coin phones will be so served.

Virtually every area of the network is being enhanced by new tech-

nology that offers better service, expense savings and more efficient use of capital. For example, digital echo canceler chips—one-third of an inch in size and containing 35,000 transistors—are now being installed in long distance switching centers throughout the country. Developed by Bell Laboratories, these chips improve transmission quality by eliminating echoes on calls over very long distances, in particular on satellite circuits.

Lightwave communications—transmission of information on a light beam sent along hair-thin glass fibers—is making its appearance in the network. Lightwave systems were installed in 1979 in Connecticut and New York—the New York installation to provide voice and video service for the 1980 Winter Olympics at Lake Placid. A long distance lightwave system is now under development to serve the major cities along the Northeast Corridor from Boston to Washington. The first link—New York to Washington—is expected to be in service in 1983.

Sophisticated electronics were also extended to the telephone cable plant that connects customer lines to the local central office. One of these systems, for example, makes it possible to link 96 customers to their local central office using six rather than 96 pairs of wire. Multiplied many times over, this means significant savings in capital.

The growing complexity and advanced technology involved in the

nationwide network require, in turn, highly sophisticated management and operating methods.

The Bell System has more than 300 kinds of computer-based systems to plan, design, operate and maintain telecommunications service. They have been a key element in the Bell System's record of productivity which, in recent years, has grown at a rate more than three times that of industry as a whole.

Computer-based systems streamline business office operations, keep up-to-date records of customer equipment and billing and process requests for service. They are used to assign telephone numbers and cables for the connection of new telephones. They are used by Repair Service Bureaus to correct troubles. They are used to select the most efficient location for new central offices, to develop designs of individual switching centers and to configure the network of cables and trunk lines that connect them. Computer-based systems keep precise records of the status and location of millions of trunk circuits—in effect providing telephone engineering and operating personnel "blueprints" of the network. They also compile and print telephone directories and provide Directory Assistance operators with current listings.

A most essential task performed

WHAT THEY DO. The Bell System jobs of the 100 employees pictured on these pages represent virtually every major facet of designing, building and operating the nationwide telecommunications network.



WALLACE BISHOP supervises the installation of private branch exchanges for Western Electric in California's Los Angeles and Ventura Counties. A resident of Redondo Beach, he is a member of the local Bell community relations team for the Torrance area. Wally's the father of four children, ages 10 to 29.



BARBARA BISSEURUP is a storeroom attendant for New York Telephone in Valley Stream, Long Island. Barbara orders telephone equipment and distributes it to technicians for installation. She is shop steward for her union and treasurer of her block association in Laurelton, New York, where she lives.



FRANCES BOOE, a plant records supervisor, is responsible for maintaining the investment and cost records on Northwestern Bell Telephone Company's outside plant facilities in Des Moines, Iowa. Fran is the mother of two adult daughters and a member of her church finance board.



WILLIAM BOUSFIELD, an associate engineer for Pacific Telephone in Los Angeles, coordinates the movement of cable and poles for new construction. A Bell employee for more than 39 years, Bill is a past bishop in the Mormon Church and currently its director for youth and men's athletics in the Los Angeles area.



GARY BOWEN is a central office technician for Mountain Bell. He maintains switching equipment in the Duncan and York Valley, Arizona, central offices. Gary lives on a 26-acre ranch with his wife Cheryl and three children. He spends his off hours raising cattle and training horses that his children ride in local rodeos.

What they do

Scientists, engineers and engineering staff



Production employees



Distribution and supply employees



Outside plant construction employees



Telephone installation and maintenance employees



Central office installation and maintenance employees



Operator services employees



Residence sales and marketing employees



Business sales and marketing employees



Clerical employees



Managers



by these operations systems is constant surveillance of the performance of the telecommunications network.

Some 26 network "diagnostic" centers monitor the flow of traffic in their areas alerting network managers to troubles or impending congestion. These centers are linked to AT&T Long Lines' national Network Operations Center in Bedminster, New Jersey. There, network managers oversee the status of the entire network. If need be, they can take swift action to reroute calls to prevent network congestion.

The ability to "manage" network calling is critical in times of emergency—for example, during the Three Mile Island nuclear reactor crisis, when five million calls in four days poured in and out of the Harrisburg, Pennsylvania area.

The value of the unified management of the network and the ability to divert personnel and equipment to devastated areas for rapid restoration of communications service were proved time and again during the year by the System's response to forest fires, tornadoes and hurricanes.

The Network

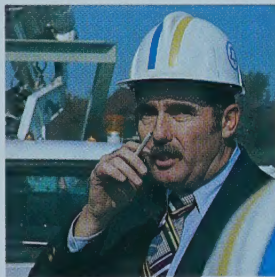
The nationwide telecommunications network carries some 750 million messages a day—voice, data, graphics—and connects some 175 million telephones via a complex web of 1.4 billion miles of microwave and cable paths and 12,000 satellite circuits. And it is linked to the rest of the world's telephones by



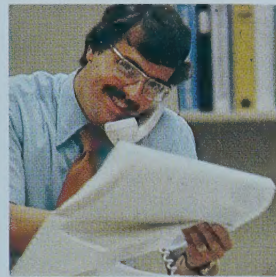
MADELINE BOYLE is a sales and service clerk at Michigan Bell's Yellow Pages office in Kalamazoo. Madeline proofreads Yellow Pages ads, reviews the contracts for them and handles a variety of other clerical duties. She joined Michigan Bell in 1948 as an operator.



MILDRED BRADY handles personnel files, capital equipment records and other administrative matters for a South Central Bell business services district in Nashville, Tennessee. A 33-year employee, she was hired as an operator when her World War II job ended with the war. Mildred is active in the Telephone Pioneers.



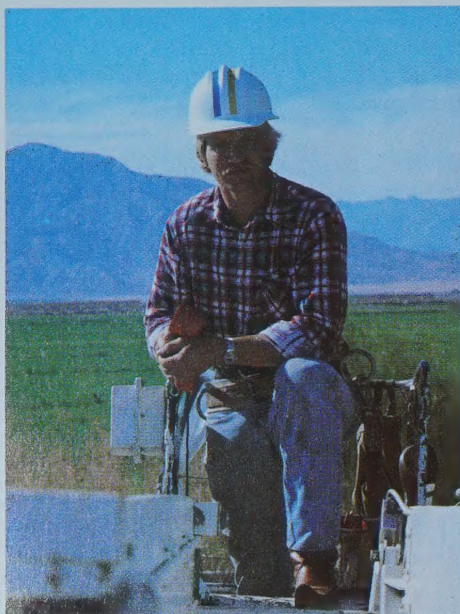
CHARLES BREEDEN supervises the testing of newly installed cable and the clearance of any transmission problems that are found for the Chesapeake and Potomac Telephone Company in Kensington, Maryland. Charlie joined C&P 26 years ago after being introduced to telecommunications work while serving in the army.



GERARD BRISSON, a marketing systems analyst at Long Lines headquarters in Bedminster, New Jersey, is working on the development of Advanced Communications Service. Eight members of Gerry's family have worked for AT&T over the years, including his wife Donna whom he met at Bedminster and who is now at home with their newborn son.



GAYLE BRODEUR, an intercept operator for Pacific Telephone in North Hollywood, tells customers when the numbers they've dialed have been changed. Gayle joined the Bell System in 1935 and has accumulated 25 years of service with time off to raise two children, one a daughter who works on central office equipment in Los Angeles.



undersea cable and satellite.

Today, new technology is opening up new potentialities for the network. Electronic switching, new interoffice signaling systems and large data bases deployed throughout the network will make possible a host of new services that customers can tailor to their specific needs. One service, for example, would enable customers to dial their local central office, record a message and instruct that it be delivered at a specified future time to any other telephone in the country.

Businesses would be able to have a single nationwide number. Customers calling that number would be connected automatically to the branch closest to them.

Another potential service would offer automatic call back when a line is busy—the network would keep checking until the busy line became free and then ring both telephones.

With "intelligence" built into the network, the range of services that can be supplied is vast, limited in large measure only by the needs and

WHERE THEY WORK. Bell System employees work nationwide. Scott Hartsock (top left) and Barrington Dubissette have like jobs a continent apart. Both splice cable, the former for Pacific Telephone in California's Imperial Valley, the latter for New York Telephone in the Bronx. On the map at right, each dot represents the work location of one of the 100 employees pictured. The sections in color represent the areas in which Bell operating companies serve. Many communities within these areas are served by Independent telephone companies—more than 1,500 of them throughout the nation.

desires of the market.

At the same time that the network is undergoing a qualitative change in the kinds of services that it offers, its geographic reach is also being extended. In particular, it is being extended internationally.

International Direct Distance Dialing was made available to 940 additional cities in the United States in 1979. Some 36 million customers in 2,600 cities across the country can dial direct to 64 foreign countries.

Plans for the seventh trans-Atlantic cable were approved by the FCC in 1979. The cable will stretch 3,400 miles from Tuckerton, New Jersey to Land's End, England. It is expected to be in service in July, 1983. The first trans-Atlantic cable, laid in 1956 and now retired, could handle 36 simultaneous conversations at a cost of \$300 per circuit mile. The newest cable can carry 4,200 conversations at once and costs \$13.60 per circuit mile.

Research is continuing on undersea cable. Bell Laboratories is evaluating the use of lightwave cable that would be able to carry nearly twice the amount of information as today's most advanced cable systems.

Communications for Business

The communications needs of today's business customers are becoming increasingly complex and diverse. To meet these needs, we have strengthened our marketing capabilities by assigning marketing experts to particular industries and segments of the business market. By



GERALDINE CALDWELL is a receptionist with Illinois Bell's employment office in downtown Chicago. She likes welcoming prospective employees and helping them with their job applications. Gerry joined the Company as a directory assistance operator in 1966 and has long been active in her church. She and her husband Silas have five children, ages 16 to 25.



JOHN CARR installs and maintains residence telephone service for Southern Bell in West Palm Beach, Florida. John's wife Natalie works for Southern Bell, too—as a TSPS operator. They have two children, ages six and nine. Out of hours, John likes to camp, spearfish and build models with his son.



JOSEPH CASHA tests data terminals for Western Electric in Nashville, Tennessee. A 24-year employee at Western, Joe has spent 16 of those years as a union officer—eight each as chief steward and local president. Joe has seven children, ages 18 to 29. Favorite after-hours pastimes include reading and golf.

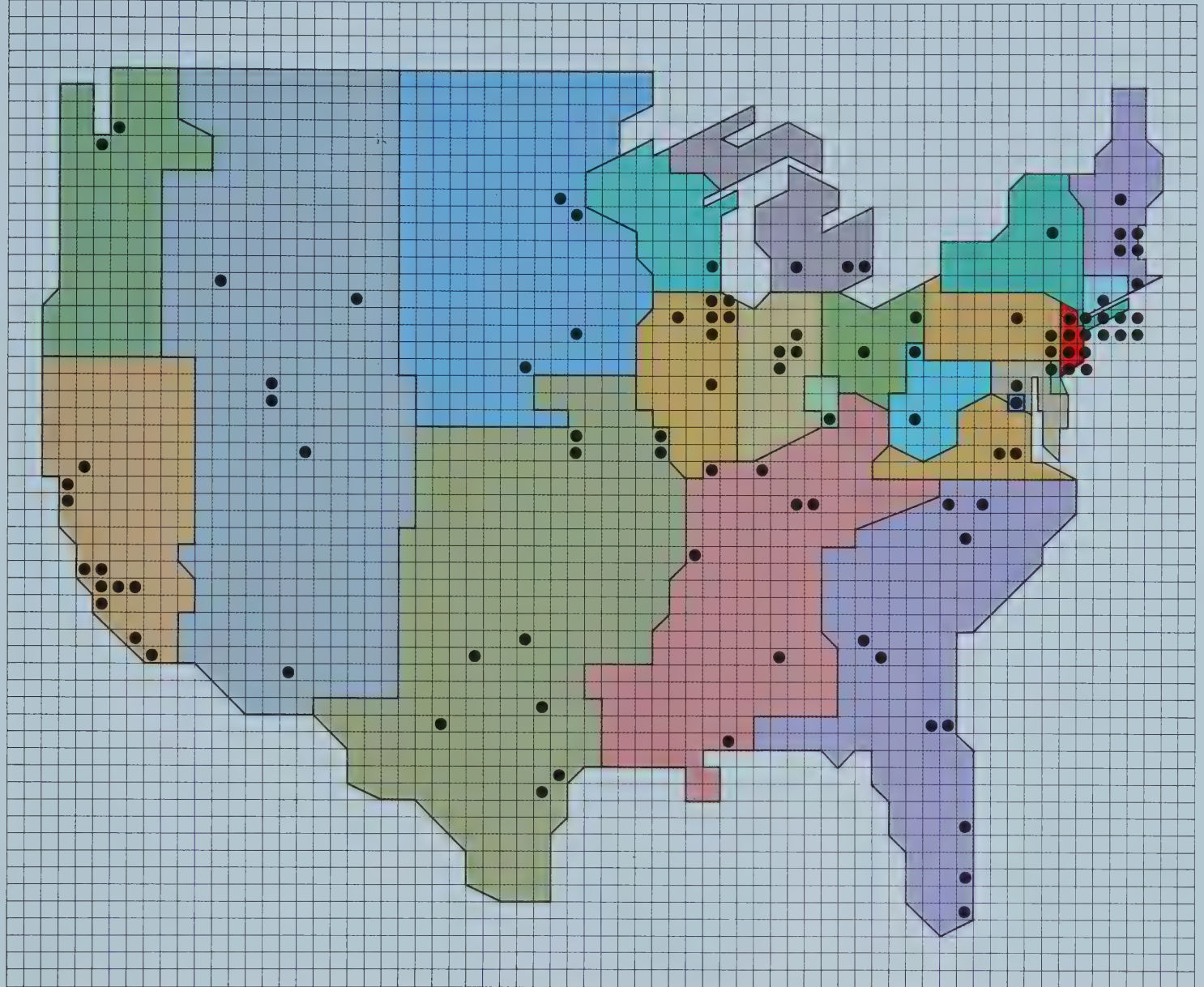


AILEEN CHUMCHAL, a Southwestern Bell service representative in Wharton, Texas, does everything from taking orders for service to taking payments for phone bills. The mother of seven children ages 11 to 23, Aileen has accumulated 13 years of perfect attendance out of her 14 with the Company. Her daughter Cindy is an electronic switching technician in nearby El Campo.



BARBARA COLLINS performs a variety of duties for a Pacific Telephone network operations group in Los Angeles that is responsible for answering-service lines and other special circuits. She's also program coordinator for the Future Pioneers who have held parties for retarded children and sent food baskets to needy families.

Where they work



SHARON COWEN is a cost analysis engineer for Pacific Telephone in San Francisco. She analyzes and tracks the billing on installations of new central office equipment. After hours, Sharon studies psychology at Ohlone College in nearby Fremont where she lives. Her husband Bob also is a Pacific Telephone engineer.



DAROL CRABTREE engineers cable facilities for Pacific Telephone in Hayward, California. He joined the Company as a cable splicer more than 30 years ago, and for 13 years he served on a local parochial school board. Darol and his wife Mildred, a registered nurse, have three adult children.



MARTHA DAHLKE is an administrative reports clerk for South Central Bell in Birmingham, Alabama. She performs a variety of clerical duties for a support services group there. After hours, she enjoys tennis, macrame, crocheting and growing plants.

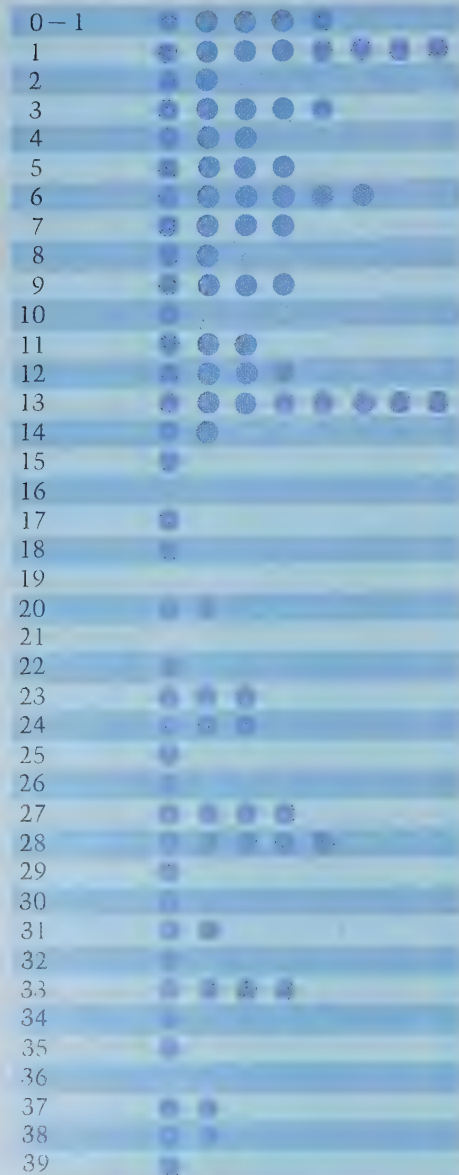


ORIANA DE FRANCO helps manufacture quartz crystal units at Western Electric's Merrimack Valley Works in North Andover, Massachusetts. Her husband Danny is a retired Merrimack Valley employee, and they have two adult children and four grandchildren. Oriana enjoys gardening and a variety of needlework.



LORETTA DEMBIA, a file supervisor for New York Telephone, handles a multitude of personnel work for the Company's legal department. A native and resident of Jersey City, New Jersey, she's been with the Company 35 years. Off the job, Loretta enjoys supporting charitable activities at her church and has traveled to almost every state in the union.

Years of service



Number of Employees



DAVID DITTRICH maintains Company vehicles for New England Telephone Company in Keene, New Hampshire. He's also responsible for purchasing parts and other materials needed to do his job. Dave likes the outdoors. A favorite pastime is camping with his wife and four children, ages nine to twenty.



WALTER DRUGAN is a department head at Bell Laboratories in Holmdel, New Jersey, and the holder of two patents. He manages the physical design of data communications products. Walt is an auto buff, enjoys boating and surf fishing and is active in his church. He and his wife Alice May have two sons and a daughter who attend college.



BARRINGTON DUBISSETTE splices cable for New York Telephone in the Bronx. Born in Kingston, Jamaica, Barrington joined the Bell System in 1968 with seven years' experience splicing cable in Birmingham, England. Barrington and his wife Patricia have five children, all of whom play the piano.



JOHN EHLING designs tools and dies for use in manufacturing equipment at Western Electric's Hawthorne Works in Chicago. He won an award there last year for one of his designs. John has worked at Hawthorne for 33 years, and his father worked there before him. Off the job he enjoys golf.



MAURICE EIKE provides staff support for all residence service centers in Virginia and West Virginia. A staff manager for the Chesapeake and Potomac Telephone Company in Richmond, he joined C&P in 1942 on the same day as his brother Al who is now retired. Maurice and his wife Anne have three children, ages 14 to 22.

YEARS OF EXPERIENCE. The Bell System service of the 100 employees pictured in this report ranges from less than one year to more than 39 as shown on the chart on the opposite page. Fifteen years is the average. Pacific Telephone's Bill Bousfield, an associate engineer, has the longest service of these employees—more than 39 years and six months.

analyzing each industry's operations and special problems, we are able to tailor communications systems to meet the unique needs of each of our customers.

Defining the needs of the market, developing communications systems to meet those problems, installing, maintaining and measuring the effectiveness of those systems are the responsibility of the "business" segment of the Bell System's organization.

Several developments occurred in 1979 that will help insure more responsive service to business customers. For example, for large businesses with multi-state operations, we expanded the number of national accounts which are handled centrally rather than by a number of local telephone companies. This makes it easier for these customers to do business with the Bell System.

To help meet the special needs of the hotel and motel industry, the Bell System introduced a version of the Dimension® 2000 PBX that, in addition to providing a wide variety of communications features, enables hotels or motels to manage their energy consumption. The initial installation in a major hotel in Atlanta is expected to reduce that hotel's energy costs by 10 per cent. It

permits hotel managers to instruct the communications system to shut down energy-consuming equipment in various parts of the hotel when it is not in use—such as lights in conference rooms and restaurants.

Two other services are worthy of note because of the great promise they hold for business users.

Picturephone® meeting service—a two-way voice and video service—currently connects Picturephone service centers in 12 cities. The high cost of energy stimulated business and government customers to make increasing use of Picturephone meeting service in 1979. While offered to date on a trial basis, we hope to be able to extend this service to more cities in the early 1980's.

Advanced Mobile Phone Service (AMPS) performed successfully in 1979 in a trial with 1,400 customers in the Chicago area. AMPS offers quality from a mobile phone that is comparable to home or office service. Unlike current mobile phone service, it can be offered to virtually an unlimited number of customers in metropolitan areas. We are waiting for regulatory approval to offer this service.

We also extended Dataphone® digital service—a high speed, private line service—to 12 more cities. It is now available on a network connecting some 60 cities. We have authorization from the FCC to extend it to 96 cities.

The Bell System also announced a new data service called Dataphone II. It was designed after extensive

study of what data users told us they want. It is easy to use and customers can build on it as their needs grow, working their way up from the most basic service to the most complex version. Dataphone II service provides a variety of levels of testing and diagnostic features that let business customers know the exact status of all of the components of their data communications systems.

A key element in Dataphone II service is the MAC-8 processor-on-a-chip developed by Bell Laboratories. It provides the "intelligence" in the system and reduces the size of the data sets significantly.

Communications for the Home

The Bell System has also organized its resources to meet the diverse needs and interests of home users. Plans for new products and services are being developed on an accelerated basis. Certain installation, maintenance and other operating personnel have been assigned exclusively to the provision of home service. In short, we believe the market for home communications is no less demanding of our best efforts than the market for business.

Home users were offered more choices and more convenience in 1979. Two new products were introduced during the year that enable customers to store as many as 12 telephone numbers and dial them automatically at the touch of a single button. One is the Touch-automatic* 12 electronic dialer that is used in conjunction with a regular

*Trademark of AT&T Company



JOAN FISCHER is a service representative for Cincinnati Bell in Covington, Kentucky. When she's not helping customers select phones for their homes or answering questions about their service, she enjoys playing the piano or gardening on the 46-acre farm she shares with her husband Bill, a machinist and part-time blacksmith.



DAVID FISHER has been a communications technician for Long Lines in Charleston, West Virginia, for 13 years. He maintains microwave radio and carrier circuits for long distance calling and special network services. Dave is an amateur radio operator and enjoys playing softball for the local Company team.



ROY FUSSELL is a test desk technician for Southern Bell in Jacksonville, Florida. He tests customers' lines to determine the cause of maintenance problems and coordinates with repair personnel to get them fixed. His wife Martha is a former Southern Bell operator. They have two sons, ages 12 and 15.



JOLENE GAILEY keeps track of telephone cable and handles other record-keeping duties for a Mountain Bell network distribution control center in Provo, Utah. A part-time employee, Jolene is a senior art major at Brigham Young University there. She has spent four years in missionary work with the Mormon Church.



BLAIR HAGERMAN is a central office technician with Mountain Bell in Boise, Idaho. He started his telephone career with Pacific Telephone in California where he met his wife Carolyn, an operator. The father of four children, Blair was a Scoutmaster for 11 years and now serves on the board of the Boy Scout troop at his church.

telephone. The other, the Touch-a-matic® S series telephone, is an electronic telephone with built-in automatic dialing. Automatic dialing is not only convenient for frequently called numbers; it also provides a rapid way of getting emergency fire, police and medical help.

Some 200 Bell System PhoneCenter Stores were added in 1979. There are now almost 2,000 of these Bell System retail outlets where customers can shop for telephones, carry them home and plug them in. Many PhoneCenter Stores also offer replacement of broken or defective phones on a "walk-in" basis. Response to these stores has been excellent. In 1979 more than half of the new phones for home customers was provided through PhoneCenter Stores.

Other services for the home grew significantly in 1979. Touch-Tone® service, for example, increased 19 per cent. Custom Calling Services, which offer features such as automatic forwarding of calls to another telephone number and abbreviated dialing of frequently called numbers, also gained during the year. Custom Calling features in service grew by 50 per cent in 1979.

We plan several trials in 1980 to determine customer interest in potential services. One involves a joint trial with Knight Ridder Newspapers and its subsidiary Viewdata Corporation of America. Some 200 homes in Coral Gables, Florida will be equipped so that customers can dial a computer data base and

"order" information on a wide variety of subjects—such as current events, restaurant reviews, shopping bargains—to be displayed on a television screen.

Directory and Public Services

We also made special efforts during the year to make directory and coin services more responsive to customer needs. We conducted tests, for example, of neighborhood directories, separate Yellow Pages for home and business users, and advertising supplements in new directories. A concept trial was also held in 1979 in which customers could call a data base to retrieve directory listings and other information such as sports results, time and weather. The information was displayed on a TV-like screen. Additional tests are planned for 1980.

Public telephone service was also made more convenient with the extension of "coinless" public phones—for credit-card and collect calls—to most major transportation terminals.

Bell System Operating Companies

Nineteen seventy-nine was a busy year for Bell System operating telephone companies. They installed some 36 million telephones and removed 31 million. They spent \$15.2 billion for construction—96 per cent of the Bell System's overall construction program. They provided 93 per cent of the Bell System's operating revenues.

HOME COMMUNICATIONS. The Bell System's 1979 restructuring created organizations at AT&T and all operating companies dedicated to meeting the changing telecommunications needs of residence customers. Hal Morris maintains home telephone service for Mountain Bell customers in Salt Lake City.

The Bell companies—along with AT&T—made special efforts through Consumer Affairs Committees to meet the special needs of consumers and to make it easier for them to deal with our business. The Bell System, for example, committed itself to improving service to customers with physical disabilities. We will establish, by mid-1980, teletypewriter operator services for the growing number of voice- and hearing-impaired customers who use teletypewriters to communicate. These services will be available nationwide through regional toll-free "800" numbers.

The Bell companies also continued to make energy conservation a priority objective. Despite an increase of 60 per cent in volume of business since 1973, Bell System energy consumption has declined more than seven per cent—with savings equivalent to 23 million barrels of oil. As part of its energy-conservation efforts, the Bell System operates some 60 solar installations and is testing 150 vehicles powered by compressed gas, gasohol or batteries.

In 1979, the Bell System purchased about \$1.8 billion in telecommunications products from general trade suppliers. About one-third of all Bell System expenditures for tele-



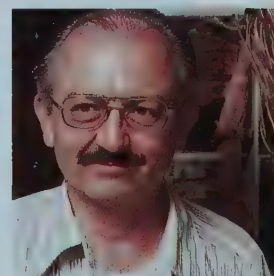
NAOMI HARTMAN, an operator with Indiana Bell for 28 years, last year learned to use a new, computerized Traffic Service Position in Muncie to help customers speed their operator-assisted calls. A member of the American Business Women's Association, Naomi has three sons.



SCOTT HARTSOCK splices cable for Pacific Telephone in El Centro, California. A graduate of Imperial Valley College, Scott has been with the Company a little more than a year. He likes the outdoors and spends much of his spare time hunting, playing baseball and flying model airplanes which he builds.



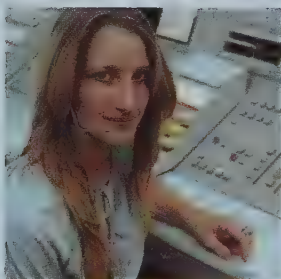
LYNN HODGE installs and maintains home telephone service for South Central Bell in Memphis, Tennessee. He and his wife Derrie, a school teacher and assistant principal, have two children. Lynn is an avid model railroader and is building an extensive model railroad layout with several other enthusiasts.



CHARLES HOERAUF installs and maintains private branch exchanges and key telephone systems for New York Telephone in Schenectady. Charlie and his wife Nancy have raised six children, ages 15 to 27, yet he's still found time for a long list of hobbies including vegetable gardening, oil-painting and deer hunting.



RICHARD HOLT supervises the placing and removal of telephone cable for Mountain Bell in Grand Junction, Colorado. Off the job, Dick builds corrals and barns, plays the guitar and enjoys horseback riding. He and his wife Sandra have four children who have performed native dances with the local American Indian Club.



LOU ANN HUGGINS has been a telephone operator for Southwestern Bell in Oklahoma City for three years. She uses one of the new electronic Traffic Service Positions to help customers place their calls. A resident of Mustang, Oklahoma, Lou Ann has a two-year-old daughter.



DENISE HUNT handles a variety of clerical duties for a Pacific Northwest Bell construction group in Seattle. A native of Moses Lake, Washington, she joined the Company as an operator in 1971. In her spare time, she likes to play the guitar and piano and sing.



JO ANNE HUTZLER prepares reports and handles other office duties for Illinois Bell's business installation and maintenance forces in Rockford. Jo Anne joined Illinois Bell in 1967 as a long distance operator. A favorite pastime is attending the hockey games of her nine-year-old son Brock.



SALLY JACOX interprets and distributes new operating procedures as an operator services staff supervisor with Northwestern Bell in Omaha. She joined Northwestern as an operator 13 years ago and ranks her promotion to management an important milestone in her life. Sally has two daughters, ages 12 and 15.



CHRISTINA JOHNSON is a claims adjuster for materials shipped to Bell telephone companies from Western Electric in Atlanta. Both parents also work there—her father in public relations and her mother in accounting. Tina has been active in charitable fund drives and Junior Achievement.



RUTH JOHNSON processes service orders for Pacific Telephone customers in San Diego. Two of her sisters work for the Company, too. Off-hours, Ruth enjoys the beach and water sports and likes to garden at her new home. She and her husband Ed, a construction worker, have two children.



PAUL KACINKO is a special assistant in the comptrollers department's economic analysis organization at AT&T's Raritan River Center in New Jersey. Paul collects, computes and verifies data for economic studies that assist Bell System planners. He lives in Avenel, New Jersey, with his wife Susan.



JAMES KEANE, a supervisor in the Chesapeake and Potomac Telephone Company's residence organization, guides the work of employees handling service requests from home customers in Washington, D.C. Jim is a part-time student at George Washington University, and he and his wife Darlene, a home economics teacher, live in Laurel, Maryland.



HENRY KNAACK installs and repairs telephone service for homes and small businesses in the Tacoma, Washington, area. An employee of Pacific Northwest Bell, he lives in Graham, Washington, with his wife Karen and two children. Trained in electronics, Hank built his own television set.



EDWARD KOLASA is an engineer who develops data terminal software for Teletype Corporation, a Western Electric subsidiary, in Skokie, Illinois. Ed's father works there, too, as an engineering associate. Ed is a graduate of the University of Illinois Circle Campus and lives in suburban Rolling Meadows.

communications products, including Western Electric purchases of components for its own products, goes to outside suppliers.

Bell System operating telephone companies in 1979 received intrastate rate awards totaling \$864 million in increased annual revenues. At year's end, 12 companies had rate cases pending, with the requested amounts totaling \$1.2 billion. These requests were limited to those jurisdictions where earnings were inadequate. All requests for rate increases filed since the inception of the President's anti-inflation program conformed to the guidelines.

Bell System operating companies continued to gain regulatory approval of rate structures that provide needed revenues yet help maintain the low cost of basic home service. For example, seven companies introduced optional measured service plans in which local calls are charged on the basis of distance and duration. With measured service, the basic charge for telephone service can be kept low and additional charges are based on individual usage.

Charging for Directory Assistance

BUSINESS SERVICES. The business services organizations created at AT&T and the operating companies by our 1979 restructuring are responsible for matching communications to the unique needs of each business we serve. David Lawrence, account executive for Bell of Pennsylvania in Williamsport, is shown at left in the photograph with Franklin P. Beattie, vice-president of the Williamsport National Bank that is served by a new Dimension® private branch exchange.

is another example of customers paying on the basis of how much service they use. Directory Assistance charging has been authorized in 34 regulatory jurisdictions. While the plans vary slightly, customers in all cases receive an allotment of DA calls each month and pay for each call beyond that. Where Directory Assistance charging is in effect, generally less than 10 per cent of the customers pay any additional monthly charge. Charging for Directory Assistance helps keep down the price of basic telephone service.

While the regulatory climate in many states improved, in California the outlook remains uncertain. Earnings in that state have been among the lowest in the country for some years. In 1979, the United States Supreme Court declined to enjoin a 1977 California Public Utilities Commission (CPUC) order which—upon implementation—would reduce earnings still further and in addition would create a critical cash squeeze, seriously jeopardizing the Pacific Company's ability to finance construction and provide good service. (See Note D, page 34.) In November, the Pacific Company filed an application to increase rates \$381 million a year to provide for reasonable earnings to help finance future construction needed to prevent deterioration of service.

At the federal level, the Bell System petitioned the FCC for permission to earn at higher levels. The Company asked for permission to earn a rate of return on its interstate

capital investment of 12 per cent rather than the 9.5-10 per cent that had been authorized in 1976. The Company based its request for a higher authorized rate of return on the fact that economic circumstances—particularly the cost of capital—had changed dramatically since the FCC's 1976 decision.

Western Electric

Western Electric had an excellent year in 1979, turning in record sales while keeping average price increases for its manufactured products to about four per cent. Western Electric's price increases were well within the President's anti-inflation guidelines. Western Electric contributed some 11 per cent to Bell System net income.

In 1979, Western Electric shipped nine per cent more telephones, 16 per cent more data sets, 27 per cent more lines of electronic switching equipment and eight per cent more conductor feet of cable than in 1978.

Western Electric engineering cost reductions meant first-year savings of about \$268 million. These savings stem from a variety of innovations: from better salvage operations to new manufacturing techniques. Western Electric and Bell Laboratories engineers collaborate constantly to find new ways of cutting costs without sacrificing quality. Gold, for example, is widely used in the production of thin film circuits. With the surging price of gold, Bell Laboratories and Western Electric engineers developed a new film of



GERALDINE KONEVAL trains personnel to assign customer telephone numbers and central office lines. An employee of Ohio Bell in Youngstown, Gerry has nearly 24 years of service. Her husband Robert works for the Company, too, as a facilities specialist in outside plant engineering.



MARILYN LABISCH handles a variety of clerical duties for Wisconsin Telephone Company business installation and maintenance forces in Milwaukee. Her favorite pastime is remodeling houses. She started remodeling three years ago and already is on her third house.



ROBERT LASHER supervises the maintenance of four electronic switching systems in Kansas City, Missouri. A 20-year employee of Southwestern Bell, Bob is married and has three teen-age children. He recently coordinated the updating of operator service—from cord switchboards to electronic TSPS units—for 500 telephone exchanges.



DAVID LAWRENCE, an account executive with Bell of Pennsylvania in Williamsport, coordinates the work of a Bell team dedicated to serving the individual telecommunications needs of businesses. Dave joined the Company two years ago. After hours he follows a hectic schedule that includes teaching Sunday School and coaching youth soccer.



BEVERLY LEACH prepares performance reports for Pacific Telephone operator offices in the Los Angeles area. In her spare time, she likes to ride motorcycles with her husband Bob, a chief equipment supervisor for the Company. They have two adult children, one of whom also works for the Company as a staff clerk in Sacramento.

several metal layers in which copper replaces much of the gold in these circuits. As a result, we are realizing savings of more than a ton of gold annually—or more than \$16 million a year based on a \$500-an-ounce price for gold.

New directions in technology required the construction of new Western Electric facilities in 1979. In Illinois, Western Electric broke ground for a Network Software Center which will house some 2,500 computer program specialists. They will be developing software—the detailed instructions for computers—for a wide variety of computer applications throughout the telephone network.

At the Allentown Works in Pennsylvania, a new “clean” room was opened to handle the growing production of the 65,000-bit random access memory device used in electronic switching systems. This high-speed memory can be accessed at a speed of 170 billionths of a second.

At the Atlanta Works, a new light-guide cable production facility is under construction. Using production processes developed by Bell Laboratories and Western Electric, it will be able to produce several hundred million feet of lightguide fiber each year.

Western Electric International (WEI), a Bell System subsidiary for marketing telecommunications products and services overseas, completed in 1979 installation of a \$500-million, 6,000-mile, 273-tower microwave transmission system in

Saudi Arabia. WEI also installed an electronic switching system for local, long distance and international calls at Saudi Arabia's mammoth Jeddah Airport.

Contracts, signed in 1979, call for WEI to install a large electronic switching system in Taipei, Taiwan and to provide a 1,700-mile undersea cable linking Taiwan and Guam. The Taiwan contracts have a combined value of \$85 million.

WEI was also selected by the Republic of Korea to negotiate a five-year contract for provision of a nationwide system of local electronic switching centers.

American Bell International Inc., a Bell System company that was overseeing the development of a communications system in Iran, withdrew from Iran early in the year because of political unrest in that country. All Bell System employees returned home safely.

While contracts with telecommunications authorities in other countries did not produce a contribution to net income in 1979, we believe the growing economic interdependence of nations and the need for improved communications, especially in developing countries, mean new market opportunities for the Bell System.

Bell Laboratories

Bell Laboratories is a research and development resource of unmatched creativity. Much of its work has already been covered in this report—since it is embodied in virtually

every technological advance already described—from new network technologies and the new services they offer to new products and services for businesses and homes and the wide variety of operations support systems that the Bell System employs to operate more efficiently and economically.

Bell Laboratories continued to press forward in areas that promise great benefit in the future.

- *Digital switching*—Bell Laboratories is designing its first local digital switching office. Bell Laboratories pioneered in digital switching concepts and designed the No. 4ESS long distance digital switching system, the first of which went into service in 1976. The Bell System's first local digital central office will be placed in service in 1981.

- *Digital signal processing*—Bell Laboratories designed in 1979 a new digital signal processor—a device one-tenth of a square inch in size containing tens of thousands of transistors. The device can make more than a million additions and multiplications in a second as it filters, equalizes or cancels digital signals—critical functions in digital transmission systems.

NETWORK SERVICES organizations are a key element in the restructuring of Bell operating units that was accomplished in 1979. Building and operating the ever more versatile network of switching and transmission facilities that serves the nation is their job. Terry Savage, a Long Lines communications technician, installs high-frequency circuits at the Rockdale, Georgia, regional switching center—one of 12 such facilities in North America.



MARY ANNE LONG supervises budget and force work for Southern Bell's business installation and maintenance organization in Charlotte, North Carolina. Mary Anne has been active in a number of women's organizations, as well as in the United Way and the Chamber of Commerce.



JOHN LYNCH is a district staff manager for New England Telephone Company in Boston. He supervises personnel matters for approximately 1,600 employees who are responsible for installing the Company's central office equipment. A 38-year veteran with the Company, John and his wife Mayanne have five children, ages 10 to 26.



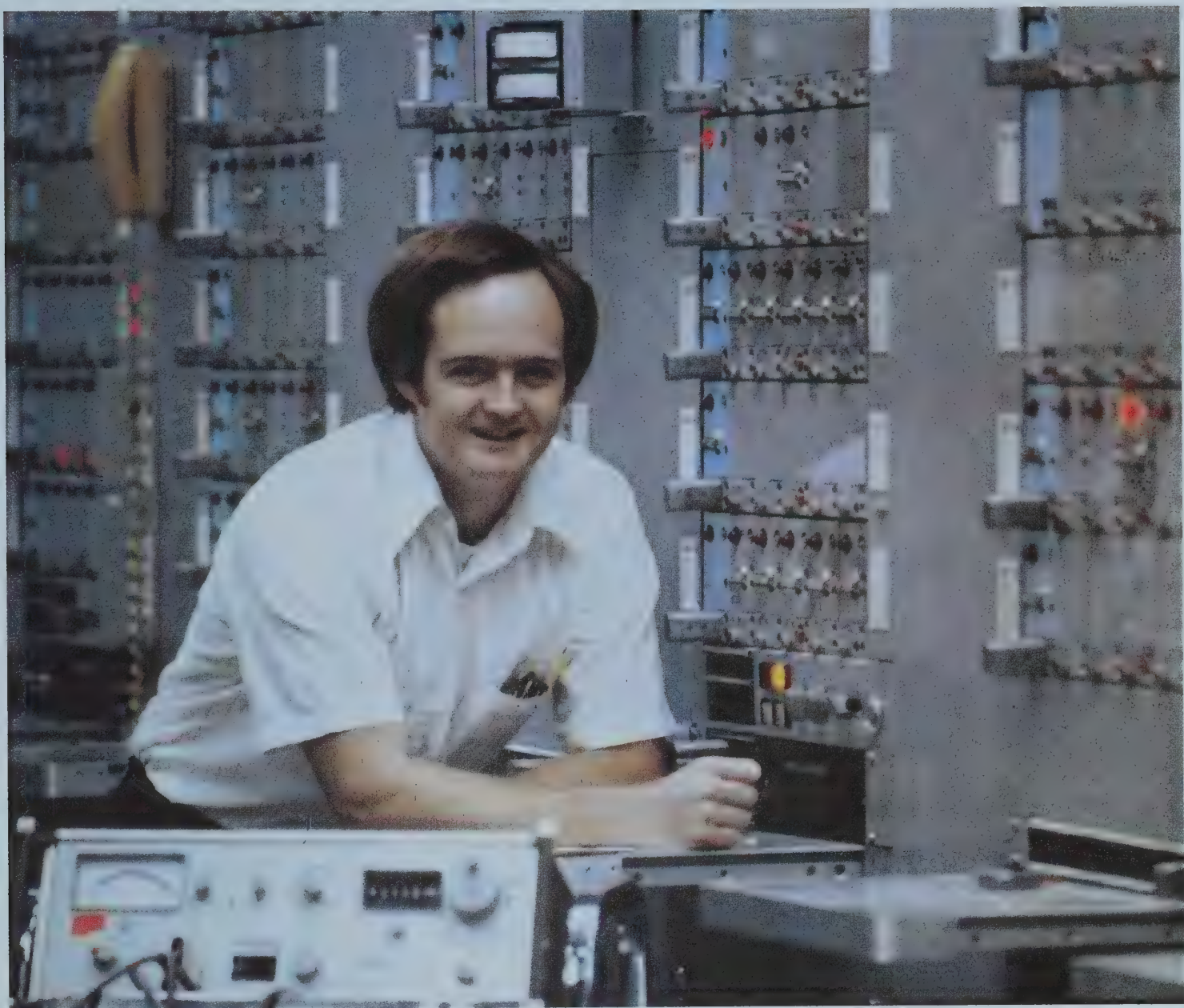
ANITA LYONS, a Western Electric employee in Lee's Summit, Missouri, near Kansas City, assembles electron tubes. After hours, she enjoys a variety of needlework, as well as camping, fishing and canoeing. She also likes to help out at a day care center.



DENNIS MACKIE, an assistant manager with Southern Bell in Lenoir, North Carolina, supervises the assignment of outside plant facilities for customer service. Denny has 28 years of service with the Company. His daughter Crystal is an outside plant technician with Southern Bell.



PETER MISTER operates mini-computers at Western Electric's data center in Warrenville, Illinois. His work group reproduces programs that operate electronic switching systems—the only Bell System group that does this kind of work. Peter plays percussion and sings background in a band with his brothers.



DEBORAH MITCHELL prepares service reports and handles other duties for a Southwestern Bell residence repair service bureau in Dallas, Texas. Debbie has been with the Company ten years and lives in Ennis, Texas. She enjoys helping out on community and charitable activities.



ELANA MORGAN provides data to AT&T computer programs that track revenues, costs and other business marketing information. An employee of Michigan Bell in downtown Detroit since 1978, Elana is studying in a pre-law program at Wayne State University.



PETER MORGAN is a senior technical associate at Bell Laboratories in North Andover, Massachusetts, where he designs digital transmission equipment. A 1978 mechanical engineering graduate of Massachusetts' University of Lowell, Pete was attracted to the Labs by the "creativity of the people."



HAL MORRIS maintains home telephone service for Mountain Bell customers in Salt Lake City, Utah. Off the job, he divides his time among family activities with his wife Peggy and their two children, service to his church and remodeling his home.



JAMES MUELLER is a communications technician for Long Lines in Allentown, Pennsylvania. He tests newly wired private line circuits—both voice and data—before they are put into service for customers. Off the job, family activities—camping and travel, especially—rate highly with Jim, his wife Sue and their four children.

- *Memory devices*—Bubble memories, invented at Bell Laboratories in 1966, were dramatically improved in 1979. Bell Laboratories engineers reduced their size by one third and increased their capacity and speed significantly. In the future, a bubble memory the size of a postage stamp may store the contents of an entire metropolitan telephone directory.

- *Lightwave research*—Bell Laboratories is developing a photochemical process to increase the purity of materials used in fabricating glass fiber lightguides. Such purity means minimal signal loss in transmission and reduces the need for amplifiers along the cable.

- *New alloys*—Chromindur III and IV—magnetic alloys for telephone ringers, receivers and relays—use one third to one half the cobalt of present magnetic alloys. This discovery alone could save the Bell System several million dollars a year.

- *Superconducting circuits*—Bell Laboratories is exploring the development of solid-state circuits that perform logic functions in trillionths of a second—up to a thousand times faster than conventional integrated circuits—while using significantly less power.

The communications technology of tomorrow will be characterized by three major trends: the continuing decline in the cost and size of solid-state electronics, the application of computers and software systems to all aspects of telecommunications and the accelerating use of stored program controlled systems

throughout the telecommunications network. These trends will open the way for a wide variety of new customer services, improve network performance, generate new revenues and achieve investment and expense savings. Bell Laboratories is at the forefront of all these trends.

Legislative, Regulatory and Judicial Issues

In 1979 Congress continued to examine in depth national telecommunications policy. At issue remained such questions as: Where is the public best served by competition, where by regulation? What conditions are needed to assure fair competition while at the same time preserving wide availability of basic telephone service and continued high performance of the telecommunications network? To what extent and under what conditions may common carriers like the Bell System provide services that involve data processing?

The focal point for addressing these and related issues was provided by three bills, one in the House and two in the Senate, aimed at revising and updating the Communications Act of 1934. Forty-seven days of hearings on these bills, before the House and Senate Communications Subcommittees, were held from April through June.

AT&T Chairman Charles L. Brown, along with 14 others, testified for the Bell System. Bell System witnesses supported the objectives of the bills—bringing the

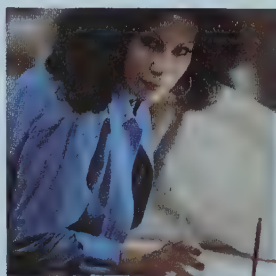
benefits of competition to the public while assuring the wide affordability of service. At the same time, they said that the bills did not sufficiently provide for unified planning, designing and operation of the nationwide network; that provisions requiring “arm’s-length” relationships among Bell System subsidiaries, such as Western Electric and Bell Laboratories, were unnecessary and could seriously impair both the quality and cost of service. In addition, they said that moving from a regulated to a deregulated environment requires a transition mechanism to keep the price of home and rural service reasonable.

Chairman Brown put AT&T on record as being “open to alternative futures” including unregulated subsidiaries in competitive markets—provided that the constraints of the Consent Decree of 1956 are lifted and that these subsidiaries remain within the overall context of the Bell System structure.

TEAMWORK among its research, manufacturing and operating units helps the Bell System match its technology to the public’s constantly changing communications needs. The shared experience of all contributes to the performance of each. The employees shown here represent, left to right, these three important parts of our organization: Research and development—Walter Drugan manages the physical design of data communications products at Bell Laboratories; Manufacturing—Senior Engineer John Ehling designs tools and dies for use in manufacturing telecommunications equipment at Western Electric; Operations—Illinois Bell’s Jo Anne Hutzler helps administer installation and repair work in Rockford, Illinois.



CAROLYN NUTTER orders and stocks equipment and other materials for Chesapeake and Potomac Telephone Company’s installation, maintenance and construction forces in Wheeling, West Virginia. Off the job, she bowls and plays softball with Company teams, and enjoys helping the local C&P community relations team with community service projects.



NILVED OWENS is a drafting clerk for Southern Bell in Miami. A native of Havana, Cuba, she is proud to have become an American citizen. She’s a member of the Company’s volunteer speakers bureau, vice president of the Dade County Democratic Women and an engineering student at Miami-Dade Community College.



CALVIN PULLIAM, a technical writing specialist for Western Electric in Winston-Salem, North Carolina, writes Bell System practices for computerized operations systems produced by the Company. Off the job, he’s an amateur radio enthusiast and especially enjoys designing and building electronic circuits. Cal and his wife Carolyn have two children.



LOUISE RAGLAND has been a directory assistance operator for New York Telephone Company in Manhattan for the past 11 years. Louise is active in a number of religious, social, community and political organizations in which she also has held elected office. She and her husband Robert have two adult children.



PATRICIA REID joined Ohio Bell as an operator in Columbus in early 1978 following graduation from Columbus Technical Institute. Pat brought experience to the job, having previously spent nearly two years as an operator on a cord switchboard there before the introduction of the electronic Traffic Service Position she now uses.



JUNE REUTTER trains Southwestern Bell service representatives in the St. Louis area. On several occasions, Southwestern has loaned June and her management talents to local fund-raising drives including the United Way and a similar effort in behalf of cultural and educational organizations.



JOHN REYNOLDS maintains air pressure in telephone cables for Diamond State Telephone Company in northern Delaware outside Wilmington. The pressure helps keep out dampness, and pressure changes alert maintenance personnel to cable damage. John has been with the Company 28 years and likes to relax at a cottage in downstate Delaware.



JOHN RICKENS supervises the special equipment shop at Western Electric in Kearny, New Jersey. His people are responsible for manufacturing a variety of test equipment including that used for testing undersea telephone cables. John has 39 years of service and he and his wife Angela, a former Western employee, have two adult children.



ALICE SALVIETTI is a teller for New York Telephone Company in the Bronx. She handles a number of duties associated with customer bill payments. A native and resident of Manhattan, Alice likes to relax while doing a variety of needlework—including crocheting, knitting and rug hooking.



TERREL SAVAGE installs high-frequency circuits as a communications technician at Long Lines' Rockdale, Georgia, regional switching center. Terry also attends Georgia State University in nearby Atlanta, and he teaches Sunday School and sings in his church choir with his wife Cindy. They have two children.



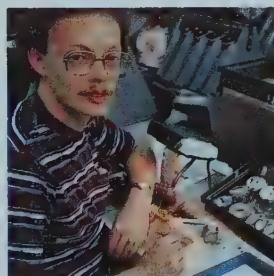
ANGELINE SCHAEFER handles personnel work for a New Jersey Bell network engineering district in Voorhees Township. A native of nearby Camden with 24 years of Bell System service, Angie now lives in Cherry Hill, New Jersey, with her husband Robert, a 33-year employee who is a New Jersey Bell district manager for network design.



WENDY SCHULTZ is an administrative clerk with the Northwestern Bell comptrollers department in Plymouth, Minnesota, where she puts payroll, billing and other data on computer discs and tapes. Out of hours, she likes to fly single-engine airplanes. She also likes to travel.



CHARLES SEARS, an assistant manager for Southern Bell in Melbourne, Florida, supervises the installation and maintenance of mobile telephones and data communications equipment. Charlie has more than 23 years of service and is a member of the Telephone Pioneers. For relaxation, he and his wife Betty and their two children enjoy the beach.



WILLIAM SHARPE tests newly assembled telephone ringers at Western Electric's Indianapolis Works. A new Western employee—he's been there less than a year—Bill lives in nearby Fountaintown with his wife Jenny Jo and their eight-year-old daughter. Bill especially likes to travel and play tennis.



BEVERLY SMILEY assigns central office lines and numbers to South Central Bell customers in Mobile, Alabama. Beverly ranks physical fitness high among her personal priorities, and she devotes a lot of time to jogging, swimming, playing tennis and taking exercise classes.

In September, President Carter issued a message to Congress supporting "Congressional efforts to reform regulation of the telecommunications industry." He urged the encouragement of competition but said that "universal availability of telephone service at affordable rates must be maintained."

In December, Rep. Lionel Van Deerlin of California introduced a new bill, which was supported by all members of the House Subcommittee on Communications. AT&T Vice Chairman James E. Olson said that the bill, while not without some problems, "appears to be a better piece of legislation than its predecessors."

At year's end, there appeared to be a growing consensus that legislation can be developed which can yield the public the benefits of competition yet not compromise the management of the basic telecommunications network or result in such dramatic increases in the price of rural and home service as to impair the wide availability and affordability of basic telephone ser-

vice. As a corollary to calling for increased competition and deregulation in the telecommunications industry, all of the legislative proposals call for relaxation of the Consent Decree of 1956 which, in general, restricts Bell System operating units to the provision of regulated services.

The FCC also addressed the structure of the telecommunications industry and other significant policy issues during the year. It moved forward with its investigation of whether long distance message telecommunications service should be supplied by a single source—the telephone industry—or competing suppliers. It outlined a series of issues that interested parties—the common carriers, specialized common carriers and others—should address. This proceeding weighs many of the same issues now before Congress. Initial comments are due early in 1980.

The Commission also issued a Tentative Decision in its Computer Inquiry—a proceeding to determine to what extent common carriers can properly employ data processing technology in furnishing services.

The Commission's Tentative Decision would allow common carriers to use data processing in the provision of communications services and permit them to provide "enhanced non-voice" services through separate entities.

The Company generally supported the Commission's decision as assuring that "a full range of new and innovative technology will be avail-

able to data communications users."

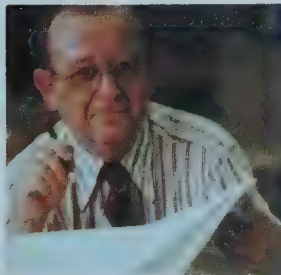
The Commission said, however, that some of the "enhanced non-voice" services could be judged data processing services and not subject to tariffs. In addition, the Commission suggested optional tariffing for enhanced terminal equipment. Since the 1956 Consent Decree refers to communications offerings subject to regulation or incidental thereto, this left some measure of uncertainty regarding the Bell System's freedom to offer such services and equipment.

Nonetheless, the Commission decision appeared to remove what some viewed as an obstacle to the Bell System's planned Advanced Communications Service (ACS)—a switched data communications service which utilizes data processing functions to facilitate message preparation, transmission and delivery. Plans to file ACS tariffs with the FCC in 1979 were delayed as a result of unanticipated problems in software development. Recent advances in technology afford the opportunity to incorporate enhanced capabilities in the redesigned system.

The Commission, in July, lifted the ban which prevented AT&T from using domestic satellites for private line services. The prohibition was imposed in 1976 to give competing companies an opportunity to establish themselves in the market. Now AT&T may use satellites for both message network and private line services.

The Department of Justice anti-

SERVICE is the end product of all 100 people pictured in these pages as it is of the Bell System's population of more than a million. Most are behind the scenes. Thelma Bell's job, however, puts her in the front lines of service. Hers is a voice you might hear if you happened to be placing a call requiring operator assistance in the Philadelphia area. She finds customers interesting, unpredictable and every one unique. And like other Bell operating people she knows that, though we number our customers in the millions, we serve them one at a time.



TELFORD SMITH helps set objectives and analyze results for residence service centers and PhoneCenter Stores in Los Angeles. A group staff manager for Pacific Telephone, Ted started work there as a draftsman 31 years ago. Nine members of his family also have worked for Bell companies, from his grandmother to his cousins.



GLORIA SPINELLI is a senior clerk in New York Telephone Company's revenue reports unit in Manhattan. A native and resident of suburban Mt. Vernon north of New York City, Gloria joined the Company 24 years ago. Off the job she especially enjoys traveling.



WYATTE STIER manages New England Telephone Company's New Bedford, Massachusetts, directory sales office. His office is responsible for selling Yellow Pages advertising in a number of local telephone directories. Wyatt's wife Carol Ann also works for the Company, as a service order writer. The Stiers have a 10-year-old son.



MARY SYKES assembles transmitters for speaker-phones at Western Electric's Indianapolis Works. She likes having a job that ultimately helps people communicate. Mary and her husband Robert have two children, ages six and 11. Mary teaches Sunday School, and she also likes to travel.



MORRIS TANENBAUM is president of New Jersey Bell. He joined Bell Laboratories in 1952 and has served as an officer there and at Western Electric and AT&T. He developed the silicon diffused transistor and holds seven patents. Active in a number of business and community organizations, he and his wife Charlotte have two children.

trust suit, seeking the dismemberment of the integrated structure of the Bell System, drew closer to trial. Judge Harold H. Greene set September 1, 1980 as the trial date.

During the year, both sides were engaged in attempts to narrow the issues in preparation for trial. The Bell System submitted a vast amount of material for Judicial Notice which we believe demonstrates the pervasive regulation of every aspect of our business—a regulatory context in which our challenged conduct was reasonable and not properly subject to antitrust attack.

Since its inception, we have urged dismissal of this suit on the grounds that antitrust laws do not apply in cases such as ours where we have been subject to such pervasive regulation under a broad public interest standard rather than the narrow competition standard of the antitrust laws.

Employee Matters

At year's end the Bell System employed 1,029,905 people, an increase of 4.7 per cent over 1978. The range of their skills, the diversity of their backgrounds, interests, years of service and jobs are well documented throughout this report. Although we are a high-technology business—and becoming increasingly so—our ability to serve the public efficiently, courteously and profitably hinges on the skill, training and dedication of employees.

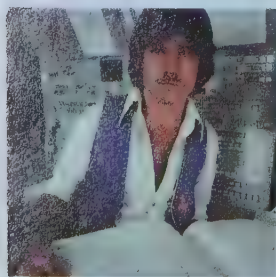
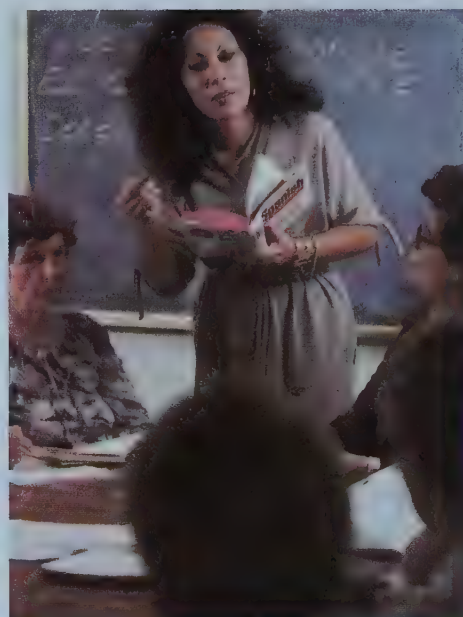
To do a high-quality job employees must have jobs worth doing, the

INTERESTS and outside activities of Bell System employees are as varied as those of Americans generally. Gary Bowen—opposite page—a central office technician for Mountain Bell in Duncan, Arizona, also is a cowboy, raising cattle and training horses. In Miami, drafting clerk Nilved Owens, above right, teaches Spanish to fellow employees during lunch time. She also studies engineering at a local college with the help of tuition aid from Southern Bell. George Whitenight, an outside plant engineer for South Central Bell, is shown, below right, helping his daughter's Brownie Scouts. He and his wife Jan also care for handicapped foster children in their home in Fancy Farm, Kentucky.

training they need, the chance to do their jobs well and the knowledge that individual progress will depend on demonstrated ability.

Several actions during the year helped assure these prerequisites. The Bell System, for example, spent some \$1.3 billion on training and conducted more than three million days of formal training throughout the country. The courses ran the gamut of virtually all the skills and disciplines required in our business. We also launched a work relationships program to help identify sources of employee dissatisfaction and to remove obstacles on the job that prevent employees from doing the best job they can.

Equal employment opportunity continued to command strong attention in the Bell System following the successful completion in January of our obligation under the Consent Decree we signed with the United States Government in 1973. Affirmative Action Programs and internal reviews of performance



MICHAEL THOLSON installs electronic switching systems for Western Electric in telephone company central offices. Based in Casper, Wyoming, he works in the same building as his parents, sister and brother, all Mountain Bell employees. Mike plays the drums and is learning to fly an airplane.



MELBORNE THRASHER is a Southern Bell associate staff manager in Jacksonville, Florida, with responsibilities for helping plan new central office facilities. After hours, Mel's interests range from amateur radio and flying a private plane to hunting with primitive weapons. He and his wife Janet have three children and live in Macclenny, Florida.



JOSEPH TORRIERI is a test desk technician for New York Telephone in Manhattan. He tests business private line circuits to locate maintenance problems. Joe and his wife Marilyn live in Yonkers with their two children. He enjoys tennis and softball as well as needlepoint and playing the chord organ.



JOANNE UNDERWOOD assists customers who suspect their phones are tapped. An employee of Michigan Bell in Southfield, Michigan, she joined the Bell System about five-and-a-half years ago. After hours, Joanne is working toward a bachelor's degree at Wayne State University.



BARBARA UPSON is a senior clerk in New Haven, Connecticut, for the Southern New England Telephone Company's toll fraud investigation unit. Barbara joined the Company more than 33 years ago as an operator. She and her husband Henry have two adult daughters and enjoy piloting their 31-foot boat to ports on Long Island and Cape Cod.



ROXANNA WATTERS tests Trimline® telephone handsets for Western Electric. A native of Oregon, Roxanna grew up in Iowa and joined the Company in Minneapolis 11 years ago. She has been treasurer of the employees' club there for more than four years. Roxanna has two children, ages three and seven.



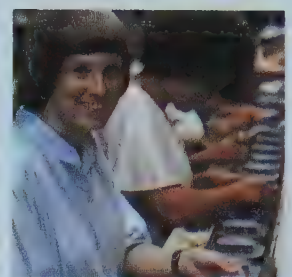
MARIE WHITE operates an electronic TSPS console to help Southwestern Bell customers in Houston, Texas, place their long distance calls. Marie has 23 years of service with the Company. One of her daughters works there, too, as a service consultant to business customers.



WILLIE WHITE crisscrosses Chicago installing data sets for Illinois Bell business customers. An honors graduate of DeVry Institute of Technology, Willie is married and has two young children. After hours, he enjoys playing and watching a variety of sports.



GEORGE WHITENIGHT is an outside plant engineer for South Central Bell in Paducah, Kentucky. He gathers data and analyzes results for a computer program that keeps track of Company needs for new cable. George and his wife Jan have two children. They also care for handicapped foster children in their home in Fancy Farm, Kentucky.



JANET WILLIAMS helps assemble push-button dials for Trimline® telephone handsets at Western Electric's Indianapolis Works. Born and raised in Indianapolis, she has a daughter, age four. Janet likes to read and finds a great sense of accomplishment in sewing.

continued in force to assure that equal opportunity remains a reality in all Bell System companies.

Community Service'

While the Bell System's prime obligation to the public is the provision of high-quality communications, we also take no less seriously our responsibilities as a "corporate citizen" of the community.

The Bell System has long supported educational, health and welfare, civic and cultural organizations that enhance the communities in which we operate. In 1979 the Bell System contributed some \$32 million to such organizations and institutions. This represents about .34 per cent of net income before taxes. Some 28 per cent of our contributions went to educational institutions, an essential source of talent for the Bell System and the community at large.

Bell System employees were also active in the thousands of communities in which we operate. Telephone people, often working as volunteers with company community relations teams, advanced job opportunities, expanded recreational programs and helped with a variety of civic improvement projects.

The Telephone Pioneers of America, an organization of more than half a million veteran telephone employees, conducted several thousand community service activities—from helping the physically and

mentally disabled to working to improve the environment.

Corporate Governance

At this writing there are 20 members of AT&T's board of directors, only four of whom are employees of the Company. The remainder are people who have achieved distinction in their chosen fields. Together they bring to the board's deliberations a wide range of experience in business, government, education and the law and the perspectives that derive from their years of proven leadership of American society.

No member of the board represents a single constituency. Each considers it his or her responsibility to reflect the interests of the entire body of the Company's share owners. The board's members recognize that only as their decisions strike a reasoned balance among the interests and concerns of most customers, employees and the public at large can they meet the long run interests of the share owners by whom they are elected.

The board of directors takes as its first responsibility to see to it that the business is well managed. It does not itself undertake to manage but rather to ensure that those it elects to lead the Company as officers are men and women of competence and character.

Much of the board's business is conducted by a number of standing

committees, the functions and memberships of which are listed on the inside back cover of this report.

In recent years, the governance of corporations and whether their accountabilities to their proprietors and to the public are effectively assured by boards of directors as they are presently constituted has been brought into public question. It has been proposed by some that federal standards governing the composition and conduct of boards be enacted into law. AT&T's board believes that its own initiatives and those of other leading companies will demonstrate that such legislation is unnecessary. Were such legislation enacted, moreover, it would impose a rigid pattern of governance on corporations that would not appropriately match their wide variation in size, scope and circumstance.

In addition to the board of AT&T, each Bell System associated company has its own board of directors responsible for assuring the competency and responsiveness of the management of those companies. These boards—also composed mainly of outside directors—make a contribution to a mode of governance—called by *Fortune* magazine a "venture in Federalism"—that, while providing for nationwide coordination and consistent national policy, at the same time permits our business to respond to the unique needs of each territory—indeed each community—it serves.



JAMES WISEMAN is a switching equipment technician who works on telephone equipment in Southwestern Bell central offices in Vernon and Chillicothe, Texas. A 31-year veteran with the Company, he previously has helped construct outside plant facilities and also has installed and maintained telephones.



CHARLIE WOOD is an outside plant technician for Southwestern Bell in Odessa, Texas. He inspects telephone cable construction work performed for the Company, by outside contractors. Charlie joined Southwestern about five years ago and previously has installed phones and spliced cable.



IRENE WOODS is a group manager of about 15 directory assistance operators at Pacific Telephone in Sacramento. A native of Canada, she prizes the day she became a U.S. citizen. She's also proud of her three sons—one a college senior and the other two, twin high school basketball stars.



BRUCE WORMAN, an outside plant technician, places and removes telephone cable for New Jersey Bell in Matawan. Bruce studied electronics in junior college, and he likes to ski and go bicycling. He and his wife Gwendolyn live in Jackson Township, New Jersey, with their two-year-old daughter.



GEORGE YOUNG installs and maintains telephone service for South Central Bell business customers in Madisonville, Kentucky. After hours, he especially likes to hunt—with a bow and arrow as well as with a gun. He and his wife Jean have four children, ages 11 to 14.

Financial Review and Consolidated Financial Statements

Report of Management

The financial statements on pages 28 through 40, which consolidate the accounts of American Telephone and Telegraph Company and its subsidiaries, have been prepared in conformity with generally accepted accounting principles applicable to rate-regulated public utilities. Such accounting principles are consistent in all material respects with accounting prescribed by the Federal Communications Commission for telephone companies, except as to the accounting treatment of investments, revenue refunds, and a California rate and tax matter as discussed in Notes to Financial Statements.

The integrity and objectivity of data in these financial statements, including estimates and judgments relating to matters not concluded by year end, are the responsibility of management as is all other information included in the Annual Report unless indicated otherwise. To this end, management maintains a highly developed system of internal accounting controls and supports a program of internal auditing to monitor compliance with the system. Management believes that this system provides reasonable assurance at reasonable cost that transactions are executed in accordance with management's authorizations and are recorded properly. This system requires that the recorded accountability for assets be compared with existing assets at reasonable intervals and it provides reasonable assurance that access to assets is permitted only in accordance with management's authorizations. Management further seeks to assure the integrity and objectivity of these financial statements by the careful selection of its managers, by organization arrangements that provide appropriate divisions of responsibility, and by communications programs aimed at assuring that its policies, standards and managerial authorities are understood.

These financial statements have been examined by Coopers & Lybrand, Certified Public Accountants. The other auditors referred to in their report are Arthur Young & Company, auditors of Western Electric Company, Incorporated and Southwestern Bell Telephone Company, and Arthur Andersen & Co., auditors of Illinois Bell Telephone Company. The auditors' report, which appears on page 40, expresses an informed judgment as to whether management's financial statements, considered in their entirety, present fairly in conformity with generally accepted accounting principles the Company's financial condition and operating results. In connection with their examination of these financial statements, the auditors have reported to management that their reviews of the Company's system of internal accounting controls did not disclose any conditions that they believe to be material weaknesses. It is generally recognized, however, that such reviews would be based on selective tests of accounting records and related data and therefore would not necessarily disclose all weaknesses which might exist.

The Audit Committee of the Board of Directors, which is composed of Directors (see inside back cover) who are not employees, meets periodically with management, the internal auditors, and the independent auditors to review the manner in which they are performing their responsibilities and to discuss auditing, internal accounting controls, and financial reporting matters. Both the internal auditors and the independent auditors periodically meet alone with the Audit Committee and have free access to the Audit Committee at any time.

R. N. Flint, *Vice President and Comptroller*

Results in Brief		1979	1978	1977	1976	1975
Earnings per Common Share		\$ 8.04	\$ 7.74	\$ 6.86	\$ 5.98	\$ 5.08
Based on average shares outstanding (in thousands)		686,109	659,843	625,878	595,184	567,915
Dividends declared per common share		\$ 5.00	\$ 4.60	\$ 4.20	\$ 3.80	\$ 3.40
(Millions of Dollars)						
Revenues	Local service	\$20,208	\$18,685	\$17,007	\$15,557	\$13,976
	Toll service	23,371	20,770	18,094	16,065	13,925
	Other (including other income)	2,604	2,289	1,902	1,492	1,323
		46,183	41,744	37,003	33,114	29,224
Expenses	Operating	30,205	26,505	23,516	21,021	18,757
	Income taxes on operations	3,619	3,837	3,268	2,905	2,364
	Other taxes on operations	3,602	3,439	3,252	2,977	2,681
	Interest	3,083	2,690	2,487	2,426	2,306
		40,509	36,471	32,523	29,329	26,108
Net income		5,674	5,273	4,480	3,785	3,116
Preferred dividend requirements		156	164	184	227	232
Income applicable to common shares		\$ 5,518	\$ 5,109	\$ 4,296	\$ 3,558	\$ 2,884
Ratio of earnings to fixed charges (Securities and Exchange Commission basis)		3.68	4.01	3.77	3.52	3.22
Main telephones ^① (in millions)		70	68	65	64	62
Extension telephones ^① (in millions)		68	65	63	59	56
Total telephones (in millions)		138	133	128	123	118
Toll messages ^② (in millions)		16,193	14,639	12,844	11,684	10,725
WATS messages ^② (in millions)		4,244	3,631	3,046	2,451	1,942

^① Recurring charges for basic telephone service (main telephones including access to the network) and for extension telephones currently account for about 17% and 4%, respectively, of total operating revenues. ^②Charges for toll messages and WATS messages currently account for about 40% and 7%, respectively, of total operating revenues.

Management Analysis of Results in Brief

In a year marked by double-digit inflation, record high interest rates and a softening of the nation's economy, AT&T's earnings showed moderate improvement over 1978.

The earnings improvement the Company achieved reflected its vigorous marketing efforts, the use of modern technology to improve operating efficiency and, in some jurisdictions, repricing of intrastate services.

Earnings per common share in 1979 were \$8.04, 30 cents or 3.9 per cent higher than 1978's per share earnings of \$7.74 which were 88 cents or 12.8 per cent better than the previous year. Income applicable to common shares increased \$409 million in 1979 compared to \$813 million in 1978. Average common shares outstanding rose 26 million in 1979 and 34 million in 1978.

Total revenues (including other income) in 1979 increased \$4.4 billion—some 10.6 per cent—compared to \$4.7 billion or 12.8 per cent in 1978. Total expenses (including taxes and

interest) rose \$4 billion or 11.1 per cent compared to a \$3.9 billion or 12.1 per cent increase in 1978.

Revenues from local and toll services in 1979 increased \$4.1 billion or 10.5 per cent compared to \$4.4 billion or 12.4 per cent in 1978 reflecting growth in calling volumes and telephones in service in both years. Higher intrastate rates accounted for a \$450 million increase in revenues in 1979 compared to a \$620 million rise in 1978. The net effect of interstate rate changes in 1979 as in 1978 was not significant. Directory revenues rose \$279 million, an 18.2 per cent increase in 1979 compared to \$216 million or 16.5 per cent in 1978. Other income included Western Electric's net income which rose \$75 million in 1979 compared to \$71 million in 1978 as a result of continuing improvement in both sales and efficiency of operations.

Operating expenses, fueled by inflation, rose 14 per cent in 1979, growing at a faster rate than local

and toll service revenues. Wages and salaries rose some 14 per cent, reflecting in part increases based on the rise in the Consumer Price Index, as provided in contracts with union-represented employees. In addition, the Company had to pay higher prices for materials and services. Specifically, operating expenses rose as a result of changes in:

Millions of Dollars	1979 versus 1978	1978 versus 1977
Wages and salaries, including cost-of-living adjustments	\$1,696	\$1,313
Total pensions and benefits	403	336
Depreciation due to increased:		
Depreciation rates	111	84
Plant investment	479	410
Materials, supplies and other payments	1,011	846
Total operating expenses	\$3,700	\$2,989

Reduction of the corporate federal income tax rate from 48 per cent to 46 per cent on January 1, 1979 was the principal cause of decreased income taxes on operations of \$218 million in 1979. Increased income taxes of \$569 million in 1978 resulted from higher income before taxes. Other taxes increased \$163 million or 4.7 per cent in 1979 as compared to \$187 million or 5.8 per cent in 1978. Gross receipts taxes increased \$19 million in 1979 compared to \$101 million in 1978. Social Security taxes increased \$168 million in 1979 and \$80 million in 1978, primarily as a result of a higher statutory rate in 1979 and higher taxable wage bases in both years. Property taxes declined \$52 million in 1979 and \$5 million in 1978 as a result of changes in property tax laws in some states.

Interest expense increased by \$393 million in 1979 as compared to \$203 million in 1978 as Bell System companies financed their construction programs at record interest rates. The average interest cost of long and intermediate term debt issued in 1979 was 10.3 per cent versus 9.1 per cent in 1978.

While some 64 per cent of our capital needs were met through internal sources, Bell System companies had to raise \$5.9 billion in external capital—\$3.4 billion in 13 long term debt issues. Interest costs on Bell System triple-A issues rose from a low of 9.41 per cent in January 1979

to a high for the year of 11.35 per cent paid by Mountain Bell in October. At the same time, AT&T continued to benefit from the Dividend Reinvestment Program and Employee Savings and Stock Ownership Plans which supplied some \$1.7 billion in new equity.

The Bell System's debt ratio (debt as a per cent of total capital) was 46.4 per cent as of the end of 1979. If preferred shares subject to mandatory redemption were included with debt, the ratio would have been 48.2 per cent.

The Decade in Review

Nearly every key measurement of the Bell System's financial and operating results increased significantly over the decade.

Earnings per common share and net income, which were \$3.99 and \$2.2 billion, respectively, in 1970, rose to \$8.04 per share and \$5.7 billion by the end of 1979. Total dividends declared more than doubled and the dividend rate per share nearly doubled, rising from \$1.4 billion and \$2.60, respectively, in 1970 to \$3.4 billion and \$5.00 in 1979.

Volume of business (revenues adjusted for rate changes) during the decade nearly doubled. Long distance messages rose from 7.2 billion in 1970 to 16.2 billion in 1979 and operating revenues increased from \$17 billion in 1970 to \$45.4 billion in 1979.

A decade of inflation took its toll on the System's expenses and construction program. Total expenses increased from \$15.1 billion in 1970 to \$40.5 billion in 1979. Construction expenditures climbed from \$7.2 billion to \$15.8 billion during the decade (with most of the increase directly attributable to the effects of inflation).

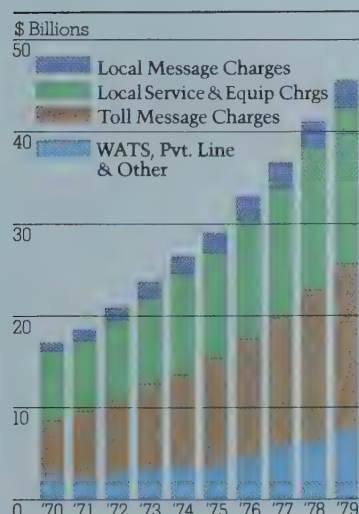
Helping to offset the effects of inflation were the System's productivity gains which were more than three times those of the private economy. As a result, overall telephone rates increased about 40 per cent during the 1970s, while the Consumer Price Index jumped nearly 100 per cent.

Market and Dividend Information

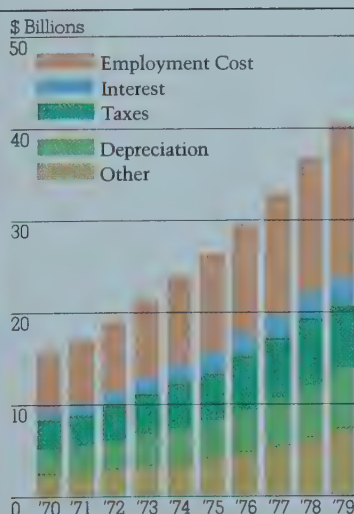
The principal market for trading in AT&T common stock is the New York Stock Exchange. Market data as obtained from the composite tape* and dividend data for the last two fiscal years are listed below.

Calendar Quarter		Market Price		Dividend Paid
		High	Low	
1978	1st	62½	56⅞	\$1.05
	2nd	63½	59¾	1.15
	3rd	63¾	58½	1.15
	4th	64⅝	59⅞	1.15
1979	1st	64¾	60¾	\$1.15
	2nd	62¼	57	1.25
	3rd	59⅞	54⅞	1.25
	4th	55¾	51¾	1.25

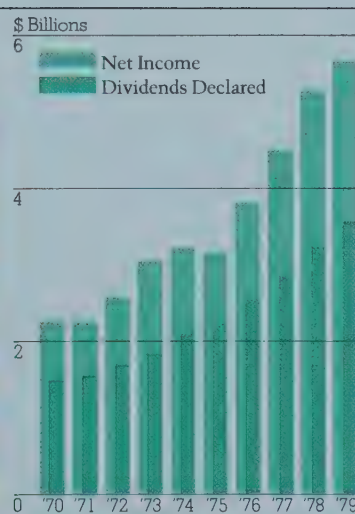
*Encompasses trading on the principal U.S. stock exchanges as well as off-board trading.



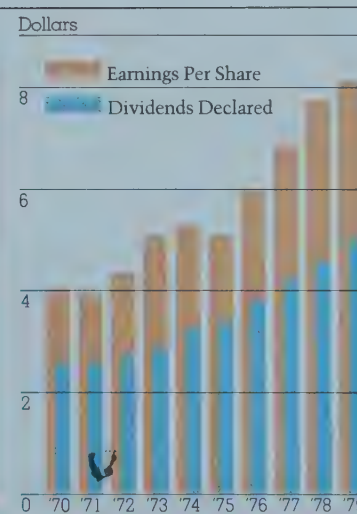
Revenues: Toll messages provided 40 per cent of our operating revenues at the decade's end. Wide Area Telecommunications Service (WATS) was the fastest growing source of revenue during the '70s.



Expenses: Growth in volume of business combined with inflation to produce a steep rise in expenses. Employment costs accounted for about 40 per cent of total Bell System expenses last year.



Net income: Over the decade net income grew at an average annual rate of 10 per cent. As earnings permitted, dividends per share were increased, rising 92 per cent over the decade of the 1970s.

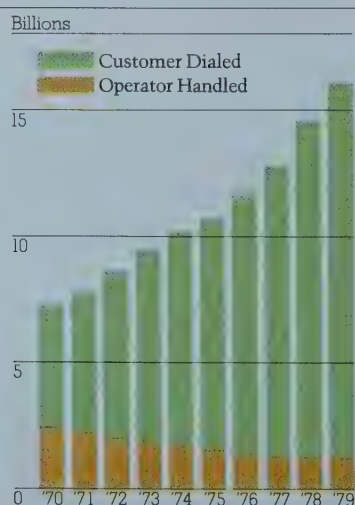


Earnings per share: Earnings have grown from \$3.99 per share in 1970 to \$8.04 in 1979 on an increased number of shares. The dividend rate was increased from \$2.60 per share to \$5.00.

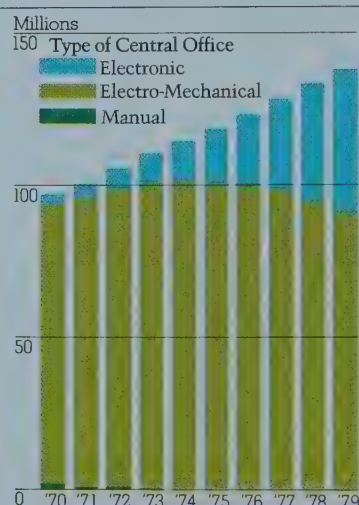
Statements of Income and Reinvested Earnings

THOUSANDS OF DOLLARS		Year 1979	Year 1978*
OPERATING REVENUES	Local service		
	Service and equipment charges	\$16,877,697	\$15,656,275
	Message charges	2,173,334	1,987,637
	Public telephones	778,504	712,377
	Private lines	378,609	328,320
	Toll service		
	Message charges	18,231,139	16,325,149
	WATS	3,175,681	2,745,684
	Private lines	1,964,616	1,699,430
	Directory advertising and other	2,288,181	1,880,743
	Less: Provision for uncollectibles	459,683	342,259
	Total operating revenues	45,408,078	40,993,356
OPERATING EXPENSES	Maintenance	9,687,438	8,460,424
	Depreciation	6,130,344	5,539,664
	Network and operator services	3,156,940	2,920,423
	Marketing and customer services	3,554,462	2,907,289
	Financial operations	1,237,234	1,092,044
	Directory	854,694	764,848
	Research and systems engineering	361,965	319,857
	Provision for pensions and other employee benefits (B)	4,082,368	3,600,479
	Other operating expenses	1,139,215	900,187
	Total operating expenses	30,204,660	26,505,215
	Net operating revenues	15,203,418	14,488,141
OPERATING TAXES	Federal income taxes (A)	3,260,705	3,494,551
	State and local income taxes (A)	358,229	342,869
	Property taxes	1,626,181	1,678,265
	Gross receipts, payroll-related and other taxes	1,975,620	1,760,233
	Total operating taxes	7,220,735	7,275,918
	Operating income (carried forward)	\$ 7,982,683	\$ 7,212,223

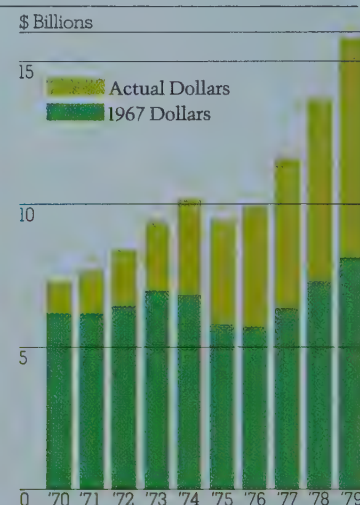
The accompanying notes are an integral part of the financial statements. *Reclassified to conform to 1979 format.



Long distance calling: The volume of toll calling more than doubled in the decade. More and more customers are taking advantage of reduced rates by dialing their own long distance calls.



Telephones: By the end of 1979 more than one-third of Bell System telephones were served by electronic central offices. The Bell System is installing these modern switching centers at a rate of about one a day.

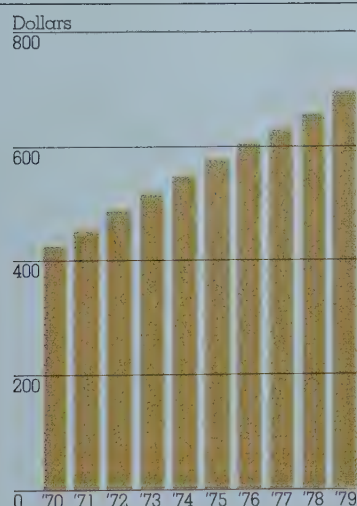


Construction: Continuing growth and improvement called for continuing expenditures for new facilities. Except for inflation, construction outlays would have been fairly stable over the decade.

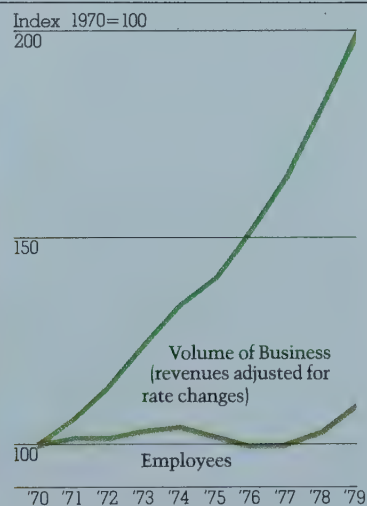
AMERICAN TELEPHONE AND TELEGRAPH COMPANY AND ITS SUBSIDIARIES

THOUSANDS OF DOLLARS

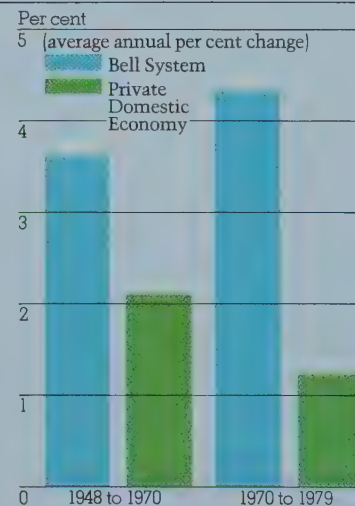
		Year 1979	Year 1978
	Operating income (brought forward)	\$ 7,982,683	\$ 7,212,223
OTHER INCOME	Western Electric Company, Incorporated net income	635,898	561,200
	Interest charged construction	221,963	270,490
	Miscellaneous income and deductions—net (C)	(82,696)	(80,625)
	Total other income	775,165	751,065
	Income before interest deductions	8,757,848	7,963,288
INTEREST DEDUCTIONS		3,083,600	2,690,682
NET INCOME		5,674,248	5,272,606
	Preferred dividend requirements	156,095	163,403
INCOME APPLICABLE TO COMMON SHARES (D) (E)		\$ 5,518,153	\$ 5,109,203
EARNINGS PER COMMON SHARE	<i>based on weighted average number of shares outstanding, 686,109,000 in 1979 and 659,843,000 in 1978 (D) (E)</i>	\$8.04	\$7.74
REINVESTED EARNINGS	At beginning of year (D)	\$19,771,576	\$17,699,401
	Add—Net income	5,674,248	5,272,606
	Miscellaneous—net	576	(252)
		25,446,400	22,971,755
	Deduct—Dividends declared:		
	Convertible preferred shares subject to redemption	36,229	42,327
	Preferred shares subject to mandatory redemption	119,331	120,300
	Common—1979, \$5.00 per share; 1978, \$4.60 per share	3,434,317	3,037,552
		3,589,877	3,200,179
	At end of year	\$21,856,523	\$19,771,576



Investment: On a per telephone basis, investment rose from \$426 in 1970 to \$696 in 1979. New technology embodied in this added investment contributed significantly to efficiency.



Employees: While the volume of business the Bell companies handled nearly doubled in the decade, the number of employees at the end of 1979 was only eight per cent higher than in 1970.



Productivity: Through new technology and improved methods, the Bell System achieved productivity gains in the '70s more than three times those of the private domestic economy.

Balance Sheets

THOUSANDS OF DOLLARS

December 31, 1979 December 31, 1978

ASSETS

TELEPHONE PLANT—at cost	In service	\$117,594,027	\$107,467,835
	Under construction	4,325,635	3,623,541
	Held for future use	30,851	33,822
		121,950,513	111,125,198
	Less: Accumulated depreciation	22,092,430	20,773,673
		99,858,083	90,351,525

INVESTMENTS	At equity (I)		
	Western Electric Company, Incorporated	4,021,576	3,512,440
	Other	426,720	375,670
	At cost	239,909	153,715
		4,688,205	4,041,825

CURRENT ASSETS	Cash and temporary cash investments—less drafts outstanding: 1979, \$563,828,000; 1978, \$552,082,000 (J)	862,560	1,421,276
	Receivables—less allowance for uncollectibles: 1979, \$170,419,000; 1978, \$130,987,000	5,832,732	5,283,926
	Material and supplies (principally at average cost)	906,524	775,015
	Prepaid expenses	177,885	175,469
		7,779,701	7,655,686

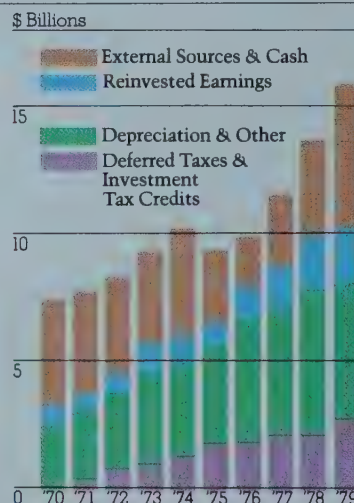
DEFERRED CHARGES		1,442,847	1,277,909
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TOTAL ASSETS		\$113,768,836	\$103,326,945
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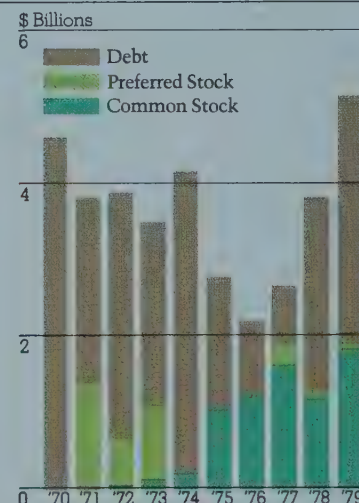
The accompanying notes are an integral part of the financial statements.



Prices: During the 1970s the Consumer Price Index rose nearly 100 per cent. During the same period, local rates increased almost 60 per cent and long distance rates rose but 20 per cent.



Financing: Internal sources were meeting two-thirds of our capital needs by the decade's end, compared to less than half in 1970—a reflection of improvements in Federal tax policy.



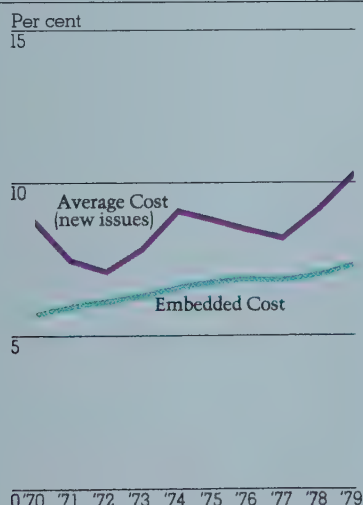
New debt and equity: \$1.8 billion in new equity was issued in 1979, mostly through dividend reinvestment and employee savings and stock plans. New debt amounted to \$3.3 billion.

THOUSANDS OF DOLLARS

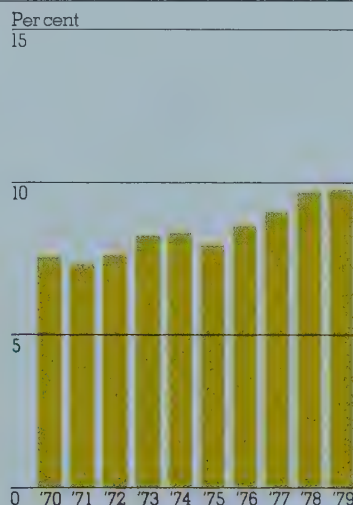
December 31, 1979 December 31, 1978

INVESTED CAPITAL, LIABILITIES, AND DEFERRED CREDITS

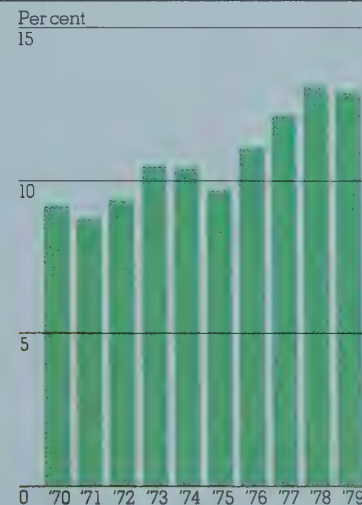
COMMON SHARE OWNERS' EQUITY		Common shares—par value \$16⅓ per share (K) Authorized shares: 750,000,000 Outstanding shares: at December 31, 1979—701,367,000; at December 31, 1978—669,549,000	\$ 11,689,457	\$ 11,159,144
	Proceeds in excess of par value		10,942,225	9,687,488
	Reinvested earnings—see page 29		21,856,523	19,771,576
			44,488,205	40,618,208
CONVERTIBLE PREFERRED SHARES SUBJECT TO REDEMPTION (L)				
	\$4 cumulative convertible preferred (includes excess of proceeds over stated value)		432,867	501,205
PREFERRED SHARES SUBJECT TO MANDATORY REDEMPTION (L)	\$ 3.64 cumulative preferred		500,000	500,000
	\$ 3.74 cumulative preferred		500,000	500,000
	\$77.50 cumulative preferred		587,500	600,000
			1,587,500	1,600,000
OWNERSHIP INTEREST OF OTHERS IN CONSOLIDATED SUBSIDIARIES			1,563,105	1,397,808
LONG AND INTERMEDIATE TERM DEBT (M)			37,495,127	34,501,138
CURRENT LIABILITIES	Accounts payable		3,255,002	2,992,463
	Taxes accrued		1,057,767	1,352,799
	Advance billing and customers' deposits		1,088,317	955,090
	Dividends payable		935,937	831,023
	Interest accrued		850,119	735,061
			7,187,142	6,866,436
	Debt maturing within one year (O)		4,106,109	3,772,028
	Taxes relating to California rate order (D)		1,304,054	1,005,565
			12,597,305	11,644,029
DEFERRED CREDITS	Accumulated deferred income taxes (D)		10,784,017	9,050,506
	Unamortized investment tax credits (D)		4,612,603	3,841,399
	Other		208,107	172,652
			15,604,727	13,064,557
LEASE COMMITMENTS (P)				
TOTAL INVESTED CAPITAL, LIABILITIES, AND DEFERRED CREDITS			\$113,768,836	\$103,326,945



Cost of debt: Interest costs of Bell System debt issues reached unprecedented highs in 1979. Over the decade the embedded cost of long term debt has increased about 1.6 percentage points.



Return on capital: Improvement in return on average capital that characterized the decade slowed in 1979, reflecting surging inflation. Resumed improvement will call for repricing.



Return to equity: Return to equity rose significantly in the 1970s but declined slightly in 1979. We are seeking regulatory recognition of higher investor requirements as a consequence of inflation.

**Statements of Sources of Funds
Supporting
Construction Activity**

AMERICAN TELEPHONE AND TELEGRAPH COMPANY AND ITS SUBSIDIARIES

THOUSANDS OF DOLLARS		Year 1979	Year 1978
FUNDS FROM OPERATIONS	Net Income	\$ 5,674,248	\$ 5,272,606
	Add—Expenses not requiring funds currently:		
	Depreciation	6,130,344	5,539,664
	Deferred income taxes—net	1,733,511	1,600,011
	Investment tax credits—net	771,204	612,763
	Deduct—Income not providing funds currently:		
	Interest charged construction	221,963	270,490
	Share of equity-basis companies' income in excess of dividends	184,376	166,079
	Total funds from operations	13,902,968	12,588,475
	Less—Dividends	3,589,877	3,200,179
		10,313,091	9,388,296
FUNDS FROM EXTERNAL FINANCING	Issuance of shares, net of redemptions	1,704,212	1,157,140
	Issuance of long and intermediate term debt	3,409,000	2,788,000
	Increase in short term borrowings—net (O)	704,081	58,304
		5,817,293	4,003,444
	Less—Retirement of long and intermediate term debt	785,011	321,559
		5,032,282	3,681,885
CHANGES IN WORKING CAPITAL* (excluding debt maturing within one year)	Cash and temporary cash investments	558,716	(138,197)
	Receivables	(548,806)	(815,646)
	Material and supplies	(131,509)	(111,624)
	Prepaid expenses	(2,416)	(5,761)
	Accounts payable	262,539	382,825
	Taxes accrued	(295,032)	304,605
	Advance billing and customers' deposits	133,227	97,486
	Dividends payable	104,914	89,601
	Interest accrued	115,058	71,968
	Taxes relating to California rate order (D)	298,489	260,584
		495,180	135,841
OTHER CHANGES*	Investments	(462,004)	(74,891)
	Deferred charges	(164,938)	(88,972)
	Ownership interest of others in consolidated subsidiaries	165,297	153,829
	Other—net	236,492	203,674
		(225,153)	193,640
FUNDS SUPPORTING CONSTRUCTION ACTIVITY		15,615,400	13,399,662
	Add—Interest charged construction	221,963	270,490
TOTAL CONSTRUCTION		\$15,837,363	\$13,670,152

*() Denotes a change which results in a decrease in funds supporting construction activity.
The accompanying notes are an integral part of the financial statements.

Notes to Financial Statements

(A) Accounting Policies—The consolidated financial statements of American Telephone and Telegraph Company ("Company") and its telephone subsidiaries reflect the application of the accounting policies described in this note. These statements have been prepared in conformity with generally accepted accounting principles applicable to rate-regulated public utilities. Such accounting principles are consistent in all material respects with accounting prescribed by the Federal Communications Commission ("FCC"), except as to the accounting for investments and revenue refunds described in this note, and as to a California rate order and related federal tax matter described in Note (D). Other policies and practices are covered in Notes (B), (J) and (P).

Consolidation—The consolidated financial statements include the accounts of the Company and its telephone subsidiaries. The consolidation process eliminates the effects of all significant intercompany transactions except as discussed below under "Purchases from Western Electric." The investment in Western Electric Company, Incorporated ("Western Electric"), an unconsolidated subsidiary, and certain other investments (where it is deemed that the Company's ownership gives it the ability to exercise significant influence over operating and financial policies) are included at equity (cost plus proportionate share of reinvested earnings). All other investments are included at cost. See also Note (I).

Revenue Refunds—The FCC's Uniform System of Accounts provides that refunds of prior years' revenues, less related income tax adjustments, be charged against current income. However, in conformity with generally accepted accounting principles applicable to rate-regulated public utilities, the Company and its telephone subsidiaries in their financial statements treat material revenue refunds applicable to prior years as adjustments of the respective years' income and, within a year, as adjustments of the applicable interim periods' income. See also Notes (D) and (E).

Purchases from Western Electric—Most of the telephone equipment, apparatus and materials used by the consolidated companies have been manufactured or procured for them by Western Electric. Contracts with the telephone companies provide that Western Electric's prices shall be as low as to its most favored customers

for like materials and services under comparable conditions. The consolidated financial statements reflect items purchased from Western Electric at cost to the companies, which cost includes the return realized by Western Electric on its investment devoted to this business.

Depreciation—Provision in the accounts for depreciation (5.6% in 1979 and 1978 of the cost of depreciable plant in service) is based on straight-line composite rates determined on the basis of the average expected lives of categories of plant acquired in a given year. The Company and its telephone subsidiaries have requested the FCC to permit such straight-line composite rates to be determined on the basis of equal life groups of certain categories of telephone plant acquired in a given year which, if granted, will increase depreciation expense above the levels that otherwise would be computed. Such increased depreciation should be allowable in determining revenue requirements in future rate-making proceedings. Depreciation for income tax purposes is provided using different lives, bases and methods. See also "Income Taxes" below.

Interest Charged Construction—Regulatory authorities allow the Company and its telephone subsidiaries to provide for a return on capital invested in certain new telephone plant while under construction by accruing interest charged construction as an item of income during the construction period and as an addition to the cost of the plant constructed. Such income is not realized in cash currently but will be realized over the service life of the plant as the resulting higher depreciation expense is recovered in the form of increased revenues.

Research and Development—The cost of basic research and systems engineering performed by Bell Telephone Laboratories, Incorporated is included as expense in determining Net Income. The cost of specific development and design work related to products to be manufactured by Western Electric is recovered in the price charged for such products (see "Purchases from Western Electric" above).

Income Taxes:

(1) The use of accelerated depreciation methods and shorter lives, permitted by income tax laws and regulations, causes depreciation charges used for tax purposes to be higher during the early years of plant life than the depreciation charges for such plant reflected in these financial statements. Appropriate income charges and their subsequent reversal, reflected as deferred income taxes—net, prevent the tax effects of these timing differences from distorting Net Income.

(2) Investment tax credits result from provisions of the federal tax law which allow for reduction in tax liability based on certain construction expenditures. Corresponding reductions in tax expense are deferred in the year they occur and, except for the additional one per cent credit available under the Tax Reduction Act of 1975 which must be contributed to the Bell System Employee Stock Ownership Plan, are amortized as reductions in tax expense over the life of the plant which gave rise to the credits.

The components of operating income tax expense, in thousands of dollars, were:

		1979	1978
Federal:	Current	\$ 782,115	\$1,309,659
	Deferred—net	1,599,288	1,478,401
	Investment tax credits—net	879,302	706,491
		3,260,705	3,494,551
State and local:	Current	209,386	209,208
	Deferred—net	148,843	133,661
		358,229	342,869
Total		\$3,618,934	\$3,837,420

Income taxes on non-operating income included in Miscellaneous income and deductions—net, in thousands of dollars, were:

		1979	1978
Federal:	Current	\$49,001	\$22,358
	Deferred—net	927	1,283
		49,928	23,641
State and local:	Current	5,797	(1,064)
	Deferred—net	14	22
		5,811	(1,042)
Total		\$55,739	\$22,599

(3) The effective consolidated federal income tax rate, as determined by dividing Federal income taxes (see section (2) above) by the sum of Federal income taxes, Net Income and ownership interest of others in the net income of certain consolidated subsidiaries, was 36.2% in 1979 and 39.4% in 1978. The differences of 9.8% in 1979 and 8.6% in 1978, between the effective rate and the federal income tax statutory rate (46% in 1979, 48% in 1978) are attributable to the following factors:

	1979	1978
a. Earnings applicable to investments in companies accounted for on an equity basis which are reflected net of income tax	3.2%	3.2%
b. Certain taxes and payroll-related construction costs capitalized for financial statement purposes, but deducted for income tax purposes, net of applicable depreciation	3.2%	3.0%
c. Interest charged construction, which is excluded from taxable income, net of applicable depreciation	.6%	1.0%
d. Depreciation, not deductible for income tax purposes, on that portion of telephone plant costs which represents profit to Western Electric	(.6%)	(.6%)
e. Amortization of investment tax credits over the life of the plant which gave rise to the credits. Such amortization reduced income tax expense for the years 1979 and 1978 by about \$316,786,000 and \$255,041,000, respectively	3.5%	2.9%
f. Other differences	(.1%)	(.9%)
Total	9.8%	8.6%

(B) Provision for Pensions and Death Benefits—The Company and its consolidated subsidiaries have non-contributory plans which cover all employees and provide for service pensions and certain death benefits. These companies have accrual programs under which actuarially determined regular payments are made to trust funds that are irrevocably devoted to service pension and death benefit purposes. The total provision for these service pensions and death benefits, including amounts charged to construction, was \$2,614,720,000 in 1979 and \$2,354,447,000 in 1978, which represented 15.5% in 1979 and 15.9% in 1978 of salaries and wages. Based on the latest actuarial valuation, it is estimated that the actuarially computed value of vested benefits exceeded the cost of trust fund assets by about \$229,110,000. The accrual programs contemplate that there will be available in the funds amounts sufficient to provide benefits as stated in the plans.

(C) Miscellaneous Income and Deductions—Net—Miscellaneous deductions include the ownership interest of others in the net income of certain consolidated subsidiaries in the amounts of \$152,707,000 in 1979 and \$133,496,000 in 1978. See also Note (A), "Income Taxes."

(D) California Rate Order and Related Matters—In August 1979 a Federal Court of Appeals lifted its stay of a September 1977 revenue refund and rate reduction order issued by the California Public Utilities Commission ("CPUC") to The Pacific Telephone and Telegraph Company ("Pacific"), a subsidiary, and in October 1979 the United States Supreme Court denied Pacific's petition for review. Upon the stay being lifted, Pacific filed proposed refund and rate reduction plans with the CPUC; to date no implementation order has been issued with respect to such plans. The Internal Revenue Service ("IRS") contends that the CPUC order renders Pacific ineligible for the federal tax benefits of accelerated depreciation and investment tax credits on plant subject to CPUC jurisdiction ("intrastate plant"); consequently, after auditing the 1974 federal income tax return, the IRS assessed a tax deficiency claiming that Pacific owed \$89,444,000 in additional taxes for the year 1974 plus related interest of \$27,019,000. Pacific paid these amounts in February 1980 and intends to file a claim for refund. Tax returns for years subsequent to 1974 are still subject to audit by the IRS and to the results of litigating the IRS assessment. Although Pacific intends to litigate the IRS assessment, these financial statements reflect the likelihood that the CPUC's order will be implemented and that, as a consequence, Pacific will be found to be ineligible for these tax benefits for 1974 and subsequent years. Accordingly, Income Applicable to Common Shares for the years 1979 and 1978 has been reduced by \$45,170,000 and \$36,108,000 (\$.07 and \$.05 per share), respectively, to reflect the revenue refunds and related interest payments applicable to these periods. Results for these periods also have been reduced by \$51,824,000 and \$36,219,000 (\$.07 and \$.06 per share), respectively, to reflect the loss of tax benefits including interest related thereto applicable to these

periods. Accumulated deferred income taxes and investment tax credits relating to intrastate plant and interest on these unpaid amounts are now included in current liabilities. Reinvested earnings as of January 1, 1978 have been reduced by \$96,407,000 for the revenue refunds and related interest and by \$51,285,000 for the loss of tax benefits including interest related thereto applicable to prior years. Should Pacific ultimately be found to be eligible, the earnings reduction and balance sheet effects related to the loss of these tax benefits would be reversed. In the opinion of counsel, Pacific's eligibility for tax benefits probably would be impaired only insofar as it relates to intrastate plant, which represents approximately 80% of Pacific's total plant. Payment of the revenue refunds and related interest and payment of the probable additional taxes and interest related thereto (all of which are continuing to grow) would substantially increase Pacific's need for cash; as of December 31, 1979 Pacific's cash needs, after taxes, for these items would approximate \$1,501,000,000. Because the ultimate outcome of these matters has not been resolved, Pacific's books of account used for regulatory purposes and its income tax returns do not reflect the loss of eligibility for tax benefits.

(E) FCC Interstate Earnings Inquiry—On September 18, 1979 the FCC ordered an inquiry to determine whether the Bell System's past interstate earnings exceeded the rate of return range approved in February 1976 by the FCC and if so, what action, if any, the FCC should take. The FCC's inquiry raises numerous questions including what time periods, amounts and services should be involved and what effects should be given to an FCC rate of return prescription. The eventual outcome of this inquiry and the effects, if any, on these financial statements are uncertain.

(F) Intrastate Revenues Subject to Possible Refund—Income Applicable to Common Shares for the year ended December 31, 1979 includes approximately \$98,470,000 (\$.14 per share) from intrastate rate increases in a number of states that are subject to possible refund. Additionally, Income Applicable to Common Shares for years prior to 1979 included approximately \$14,770,000 (\$.02 per share) from intrastate rate increases that remain subject to possible refund.

(G) Interstate Revenues Tax—In August 1979 a County Circuit Court in Illinois ruled that interstate telephone revenues earned in Illinois are subject to a messages tax and this portion of the Court decision has been appealed by the telephone company. The State of Illinois also has appealed with respect to portions of the decision relating to revenues shared with non-Bell System telephone companies in Illinois. Amounts involved relate to 1967 and subsequent years and will continue to grow. Should it ultimately be determined that these amounts are payable, Income Applicable to Common Shares would be decreased in a future year. If such determination had been made as of December 31, 1979, the decrease could have been as much as \$198,000,000 (\$.29 per share).

(H) Accounting for Station Connection Costs—The FCC has released a Notice of Proposed Rulemaking to change the accounting treatment provided in its Uniform System of Accounts for the costs of installing telephone service on a customer's premises. These costs are now being capitalized but would be expensed when incurred in the future. This change would result in increased annual operating expenses; however, such increased expenses should be allowable in determining revenue requirements in future rate-making proceedings. If these changes are adopted during 1980, the Company's telephone subsidiaries may begin their implementation retroactive to January 1, 1980.

(I) Investments at Equity—The FCC's Uniform System of Accounts requires that investments be carried on the books of the companies at cost. However, in conformity with generally accepted accounting principles, certain investments are included at equity in the accompanying balance sheets. See Note (A), "Consolidation."

The following information is provided as of December 31, 1979 for those companies carried at equity:

Western Electric Company, Incorporated and its subsidiaries

Wholly-owned and carried on the Company's books at a cost of \$1,758,797,000. The consolidated assets and liabilities were \$7,128,324,000 and \$3,106,748,000, respectively.

Other—Includes principally:

Bell Telephone Laboratories, Incorporated—50% owned and carried on the Company's books at a cost of \$175,000,000 plus \$7,000,000 of advances, which also equals its investment at equity. Western Electric owns the other 50%.

The Southern New England Telephone Company—19.9% owned and carried on the Company's books at a cost of \$76,595,000 plus \$18,500,000 of advances. The Company's equity is \$140,228,000. The market value of the shares owned by the Company based on the closing price as obtained from the composite tape was \$84,815,000.

Cincinnati Bell Inc.—28.7% owned and carried on the Company's books at a cost of \$36,489,000 plus \$6,500,000 of advances. The Company's equity is \$85,119,000. The market value of the shares owned by the Company based on the closing price as obtained from the composite tape was \$61,854,000.

(J) Cash and Temporary Cash Investments—Cash and temporary cash investments have been reduced by the amount of drafts outstanding with a corresponding reduction in Accounts Payable. It is the practice of the Company and most telephone subsidiaries to make certain payments by draft and to record such drafts as accounts payable until such time as the banks honoring the drafts have presented them for payment. The Company maintains cash and temporary cash investments not only to meet its own obligations but to maintain funds upon which the subsidiary companies may draw on a day-to-day basis to meet their obligations, including coverage for outstanding drafts.

(K) Common Shares—Book value per common share amounted to \$63.43 and \$60.67 at December 31, 1979 and 1978, respectively.

At December 31, 1979 there were 9,073,992 authorized but unissued common shares reserved for the conversion of the Company's outstanding \$4 convertible preferred shares.

Common shares outstanding increased in 1979 as follows:

1,432,764 shares issued upon conversion of the Company's \$4 convertible preferred shares. See Note (L).

14,923,918 shares sold at 95% of market for dividend reinvestments and 2,362,833 shares sold at market for optional cash payments under the Share Owner Dividend Reinvestment and Stock Purchase Plan.

11,362,600 shares sold at market to the Bell System employee savings plans.

1,736,580 shares issued at market in connection with the Bell System Employee Stock Ownership Plan through the election of an extra 1% Investment Tax Credit.

(L) Preferred Shares—Authorized are 100,000,000 preferred shares at \$1 par value.

**CONVERTIBLE PREFERRED SHARES
SUBJECT TO REDEMPTION**

In Thousands	December 31, 1979	December 31, 1978
Outstanding:		
\$50 stated value:		
\$4 cumulative convertible preferred	8,620 shares	9,981 shares
Proceeds in excess of stated value	\$1,852	\$2,134

Each \$4 preferred share is convertible into approximately 1.05 common shares of the Company. 1,361,125 and 1,842,152 of such shares were converted during 1979 and 1978, respectively. Each share may be redeemed by the Company at stated value; however, such redemption is not required.

**PREFERRED SHARES
SUBJECT TO MANDATORY REDEMPTION**

In Thousands	December 31, 1979	December 31, 1978
Outstanding:		
\$50 stated value:		
\$3.64 cumulative preferred	10,000 shares	10,000 shares
\$3.74 cumulative preferred	10,000 shares	10,000 shares
\$1,000 stated value:		
\$77.50 cumulative preferred	588 shares	600 shares

The \$3.64 preferred shares may be redeemed by the Company at a premium of \$3.02 per \$50 share on or before April 30, 1980 and at a diminishing premium thereafter. On May 1 of each year, commencing in 1984, the Company through a sinking fund must redeem without premium 3% of these shares; an additional 3% may

be redeemed each year at the Company's option.

The \$3.74 preferred shares may be redeemed by the Company at a premium of \$3.10 per \$50 share on or before January 31, 1981 and at a diminishing premium thereafter. On February 1 of each year, commencing in 1985, the Company through a sinking fund must redeem without premium 3% of these shares; an additional 3% may be redeemed each year at the Company's option.

The \$77.50 preferred shares may be redeemed by the Company at a premium of \$59.80 per \$1,000 share on or before January 31, 1981 and at a diminishing premium thereafter. On February 1 of each year, the Company through a sinking fund must redeem at stated value 12,500 of these shares through 1992 and 18,750 shares each year thereafter and may redeem an additional equal number each year at the Company's option. Under these sinking fund provisions, which became effective in 1978, the Company redeemed 12,500 shares on February 1, 1980 and February 1, 1979 which reduced stated capital (as defined in the New York Business Corporation Law) by \$12,500,000 in each year.

The sinking fund requirements for preferred shares subject to mandatory redemption are cumulative; that is, should redemption amounts not be set aside in full because the net assets of the Company are insufficient, or for any other reason, such amounts must be set aside, without interest, before any common share dividends are paid or declared, or any common shares are purchased or redeemed.

All preferred shares rank prior to the common shares both as to dividends and on liquidation but have no general voting rights. However, if dividends are in default in an amount equal to six quarterly dividends on any series of preferred shares, the number of directors of the Company will be increased by two, and the holders of all preferred shares will have the exclusive right, voting separately as a class, to elect such two additional directors so long as such default continues.

(M) Long and Intermediate Term Debt—Interest rates and maturities on long and intermediate term debt outstanding at December 31, 1979 were as follows:

Millions of Dollars				
Maturities	2½% to 6½%	7% to 8½%	9% to 12.70%	Total
1981	\$ 170	\$ 275	\$ 150	\$ 595
1982	365	420	—	785
1983	235	250	—	485
1984	355	50	150	555
1985-1994	3,407	313	—	3,720
1995-2004	4,855	2,770	2	7,627
2005-2014	2,162	9,617	1,774	13,553
2015-2019	—	5,370	4,805	10,175
Total	\$11,549	\$19,065	\$6,881	\$37,495

(N) Subsequent Financing—As of February 8, 1980 seven telephone subsidiaries have sold, contracted for sale or announced their intention to sell up to \$1,650,000,000 of long term debt. The proceeds of these sales have been or will be applied toward repayment of debt maturing within one year.

(O) Debt Maturing Within One Year—The Company's telephone subsidiaries follow the practice of financing construction of telephone plant partially through bank loans, commercial paper, commercial notes and other notes payable in twelve months or less after issuance, pending long term financing.

Debt maturing within one year is included as debt in the computation of debt ratios and consists of the following:

	Millions of Dollars		Weighted Average Interest Rates	
	1979	1978	1979	1978
Notes payable:				
Bank loans	\$ 843	\$1,134	14.1%	10.8%
Commercial paper	1,999	1,823	13.2%	10.1%
Commercial notes	656	—	13.2%	—
Other notes	193	30	12.8%	10.5%
Long and intermediate term debt maturing within one year	415	785	—	—
Total	\$4,106	\$3,772	—	—
Average amounts of notes payable outstanding during the year	\$3,069	\$2,869	11.2%†	7.9%†
Maximum amounts of notes payable at any month end during the year	\$3,691	\$3,146	—	—

†Computed by dividing the average daily face amount of notes payable into the aggregate related interest expense.

(P) Lease Commitments—The Company and its consolidated subsidiaries lease certain facilities and equipment used in their operations and reflect lease payments as rental expense of the periods to which they relate. Total rental expense amounted to \$1,004,737,000 and \$897,480,000 in 1979 and 1978, respectively. At December 31, 1979 the aggregate minimum rental commitments under noncancellable leases for the periods shown were approximately as follows:

Years	Thousands of Dollars
1980	\$ 523,138
1981	452,339
1982	381,467
1983	317,563
1984	247,565
Thereafter	2,668,517
Total	\$4,590,589

These leases include some which would be classified as "capital leases" under criteria established by the Financial Accounting Standards Board. However, for regulatory accounting and rate-making purposes, such leases are not capitalized. Had such leases been capitalized, additional assets of \$1,057,835,000 and \$1,017,528,000

(net of \$515,642,000 and \$432,015,000 accumulated amortization) and obligations of \$1,139,795,000 and \$1,108,047,000 would have been included on the Balance Sheets as of December 31, 1979 and 1978, respectively; the effect on Net Income would have been insignificant. Under regulatory rate-making procedures, any such expense effects are not recognized currently but are recognized instead over the life of the respective lease.

(Q) Department of Justice Antitrust Action—In 1974 the Department of Justice brought a civil antitrust action naming the Company, Western Electric and Bell Telephone Laboratories, Incorporated as defendants, and the 23 Bell System telephone companies as co-conspirators but not defendants. This matter is not likely to be resolved for several years. The Company believes that the relief sought, which includes dismemberment of the Bell System, is adverse to the public interest and it is confident that it has not been in violation of the antitrust laws and that the structure of the Bell System will remain basically unchanged. In the opinion of the Company, dismemberment of the Bell System would have adverse effects on its business, could affect its ability to raise capital, its credit standing and the market value of its securities and could require an immediate payment of federal income taxes previously deferred on intercompany profits. A lump sum payment of such deferred taxes, which are being credited to the plant accounts, would have no direct effect on net income but would materially increase the need for cash and revenues.

(R) Quarterly Financial Information (Unaudited) — Subject, with respect to all periods presented, to the ultimate resolution of the matter referred to in Note (E), all adjustments necessary for a fair statement of income for each period have been included.

Calendar Quarter	Millions of Dollars			
	Total Operating Revenues	Operating Income	Income Applicable to Common Shares	Earnings Per Common Share*
1978				
1st	\$ 9,838	\$1,731	\$1,226	\$1.88
2nd	10,158	1,806	1,287	1.96
3rd	10,403	1,873	1,351	2.04
4th	10,594	1,802	1,245	1.86
Total	\$40,993	\$7,212	\$5,109	\$7.74
1979				
1st	\$10,850	\$1,915	\$1,321	\$1.96
2nd	11,251	1,994	1,410	2.07
3rd	11,563	2,034	1,405	2.04
4th	11,744	2,039	1,382	1.98
Total	\$45,408	\$7,982	\$5,518	\$8.04

*Because of increasing numbers of common shares outstanding each quarter, the sum of quarterly earnings per common share may not equal earnings per common share for the year.

Results for the quarters of 1979 include approximately \$6,570,000, \$18,590,000, \$24,050,000 and \$49,260,000 (\$.01, \$.03, \$.03 and \$.07 per share) of Income Applicable to Common Shares resulting from intrastate rate increases which are subject to possible refund. See Note (F).

(S) Accounting for the Effects of Inflation (Unaudited) –

Supplementary Financial Data Adjusted for the Effects of Changing Prices—December 31, 1979

Millions of Dollars (except per share amounts)			
	As Reported in the Historical Cost Financial Statements (a)	Adjusted for General Inflation (Constant Dollars) (b)	Adjusted for Changes in Specific Prices (Current Costs) (c)
Operating revenues	\$45,408	\$45,408	\$45,408
Depreciation	6,130	9,967	9,544
Other operating expenses	24,075	24,075	24,075
Operating federal income taxes	3,261	3,261	3,261
Other operating taxes	3,960	3,960	3,960
Other income	(775)	(775)	(775)
Interest deductions	3,083	3,083	3,083
	39,734	43,571	43,148
Income from continuing operations (excluding reduction in net re- coverable amount of plant investment)	\$ 5,674	\$ 1,837*	\$ 2,260
Income from continuing operations per com- mon share (after pre- ferred dividend requirements and excluding reduction in net recoverable amount of plant investment)	\$8.04	\$2.45	\$3.07
Reduction in net recov- erable amount of plant investment		\$ 974*	\$ ____*
Benefits from decline in purchasing power of net amounts owed		\$ 6,841	\$ 6,841
Amount by which current cost of telephone plant would have increased if computed by reference to changes in general price levels			\$18,279
Increase in current cost of telephone plant			8,593
Difference, primarily due to benefits of technological improve- ments in constructing telephone plant			\$ 9,686
Net assets at year end	\$46,484	\$97,376*	\$89,837*

Double-digit inflation has drawn increased attention to the need to assess both the impact of inflation on business and the success of management in coping with it. Numerous reporting methods have been proposed to provide such an assessment, but no consensus has been reached either on the preferability of any one method or on the practical usefulness of the resulting data. The Financial Accounting Standards Board ("FASB") believes that additional experience should be gained and experimentation undertaken with respect to reporting the effects of inflation. Accordingly, the FASB has issued Statement of Financial Accounting Standards No. 33 which requires disclosure of supplementary data to reflect the effects of general inflation (constant dollar) and the effects of changes in specific prices (current cost). The foregoing data have been prepared to comply with Statement No. 33; however, the Company believes that it should be used with care because inflation reporting is still in an experimental stage and the data neither completely nor accurately portray inflation's effects.

Traditionally, financial statements have been prepared on the basis of historical costs, i.e., the actual number of dollars exchanged at the time each transaction took place. However, it is recognized that general inflation has caused the purchasing power of dollars to decline, the result of which is the presentation of financial statement elements in dollars of varying purchasing power. To eliminate this disparity, such elements may be restated in "constant" dollars, each of which then has equal purchasing power. To reflect the effects of inflation and thus express operating results in dollars of comparable purchasing power, Statement No. 33 requires the Company to show what the FASB characterizes as "income from continuing operations" as if depreciation of plant assets had been based on asset amounts expressed in dollars of constant purchasing power. (This is shown in column (b), stated in average 1979 dollars.) This adjustment is derived from the application of the Consumer Price Index for All Urban Consumers ("CPI-U"), a measure of inflation based on changes in the costs to consumers of a wide range of commodities and services. (The 1979 average CPI-U has been estimated based on actual statistics through November 1979.)

Technological improvements, changes in supply and demand, and productivity gains cause the specific prices of goods and services purchased by a particular business to fluctuate differently from price changes that would be

*The constant dollar and current cost amounts of telephone plant have been reduced because regulatory authorities in one state have limited revenues to an extent that the recoverable amount of such plant in that state has been impaired.

Income from continuing operations on a constant dollar basis reflecting the foregoing reduction in net recoverable amount for 1979 would be \$863,000,000. Cumulative reductions for all years through December 31, 1979 of \$7,208,000,000 are reflected in the cost of telephone plant stated in constant dollars which, net of accumulated depreciation, was \$156,750,000,000 at December 31, 1979.

Income from continuing operations on a current cost basis for 1979 would not have been affected by the foregoing reduction in net recoverable amount because current cost depreciation provided for any 1979 reductions that otherwise might have been necessary. However, cumulative reductions applicable to all years through December 31, 1979 of \$6,160,000,000 are reflected in the current cost of telephone plant which, net of accumulated depreciation, was \$148,746,000,000 at December 31, 1979.

caused solely by general inflation. To reflect the effects of such specific price changes on operating results, Statement No. 33 requires that the Company also show "income from continuing operations" as if depreciation of plant assets had been based on the "current cost" of these or comparable assets, rather than on historical cost. (This calculation is shown in column (c), stated in average 1979 dollars.) Because current cost data are unique to each company, the current cost of telephone plant has been calculated by applying internally generated indexes to investments in each of the major telephone plant accounts.

In computing "income from continuing operations," only depreciation expense has been adjusted to show the effects of inflation. Because most other operating expense items are current year transactions, they already are recorded in dollars of approximately current purchasing power.

In accordance with requirements of Statement No. 33, no adjustments have been made to reflect any effects of inflation on provisions for federal income taxes. The effective tax rate (operating federal income taxes divided by the sum of operating federal income taxes and "income from continuing operations") for the historical data in column (a) would be 36.5%. The rate reflecting adjustments for inflation would be 64.0% for column (b) and 59.1% for column (c). While the federal income taxes used in these computations include Investment Tax Credits and tax deferrals relating to accelerated depreciation, the effects of inflation on effective tax rates also would be dramatically increased, even though in lower percentages, if these tax benefits were excluded. These tax benefits were intended by Congress to provide funds for investment in other capital assets in order to increase productivity and employment. Inflation's dramatic increase in effective tax rates indicates that there is need for action by Congress to control inflation and further to stimulate investment of more capital in business.

Amounts shown as "net assets at year end" are the sum of common share owners' equity, convertible preferred shares subject to redemption, and the ownership interest of others in consolidated subsidiaries as shown in the historical cost financial statements, adjusted for general inflation (column b) by the difference between telephone plant at historical cost and telephone plant in constant dollars and adjusted for changes in specific prices (column c) by the difference between telephone plant at historical cost and telephone plant at current cost.

It is essential that regulatory authorities allow telephone services to be priced at levels that will preserve the Company's ability to attract the continuing additional amounts of capital necessary to meet the public's demand for telephone services. Such price levels need to provide rates of return which, giving recognition to the effects of inflation, will adequately compensate purchasers of securities for funds provided for telephone plant construction. This inflation-affected compensation would acknowledge higher interest rates for debt securities in anticipation that such debt will be repaid in

dollars having less purchasing power; it would acknowledge that returns on equity securities must be comparable with returns available on alternative equity investment opportunities. Because of this comparable return requirement for equity securities, any reflection of "constant dollar" or "current cost" depreciation in the returns on equity of non-regulated companies should result in regulatory recognition of the need for increased returns on equity for the Bell System and thus give recognition to similar inflation effects on its depreciation. Accordingly, the Company has no reason to expect that increases in operating revenues will not keep pace with the effects of inflation on depreciation; the constant dollar and current cost amounts shown for telephone plant investment in the accompanying schedule reflect this premise. Such amounts do reflect reductions resulting from regulatory actions in one state which indicate that the recoverable amount of telephone plant in that state is lower than the corresponding constant dollar and current cost amounts. Should other regulatory authorities not give recognition to the need for such higher equity returns, then the recoverable amount of the Company's plant, when adjusted for inflation's effects, could be further reduced, causing reductions in net recoverable amounts. The amount of such additional reduction applicable to constant dollar results in 1979 (column b) could have been as much as \$7,486,000,000; the cumulative amount of such reductions at December 31, 1979, could have reduced "net assets," as defined in this note, by as much as \$53,590,000,000. No reduction applicable to current cost results in 1979 (column c) is necessary; current cost depreciation provided for any 1979 reduction that otherwise might have been necessary. However, the cumulative amount of current cost reductions applicable to all years through December 31, 1979, had they been required, could have reduced net assets at December 31, 1979 by as much as \$46,051,000,000.

The reader should note the item identified in the supplemental schedule as "benefits from decline in purchasing power of net amounts owed." During inflation lenders of money experience a loss due to the fact that amounts owed to them will be repaid in dollars having less purchasing power than the dollars originally lent; it is in anticipation of such loss that interest rates are so high during inflationary times. Conversely, to the extent that lenders are losing purchasing power, borrowers are benefitting. In assessing the impact of inflation on business, the Company believes that the benefits from inflation's effects on money that is borrowed should be viewed as an offset to interest expense, thus holding down its costs of providing service to customers.

The disclosure called for by Statement No. 33 is misleading by its incorrect inference that the Company may have paid out more in dividends than its net income justified. The Company's dividend policies comply with legal requirements applicable to all businesses and are based on many considerations including the desire of its share owners to receive a cash return on their investment.

Readers should note that the increase in the specific prices of telephone plant actually has been less than the general increase in the rate of inflation. This difference

primarily is attributed to "benefits of technological improvements in constructing telephone plant." These technological improvements, combined with the resulting improvements in productivity, have been responsible for the Company's success in keeping the rate of growth in the prices of its services below the rate of growth in the general level of prices.

Statement No. 33 also requires that a Supplementary Five-Year Comparison of Selected Financial Data be presented showing certain information restated into the average purchasing power of the dollar during 1979. The calculations for operating revenues and cash dividends declared per common share have been made by applying the average CPI-U for 1979 to the data for the years 1975 through 1978. The effect of these calculations is to increase the number of dollars shown for each year as compared to the actual number of dollars received or spent. The calculations for market price per common share have been made by applying the average CPI-U for 1979 to the data for the years 1975 through 1979. Since the actual market price for 1979 is stated in year end dollars which have a lower purchasing power than the average 1979 dollar, the effect of the calculation for 1979 is to decrease the market price per common share from the actual quoted amount.

Supplementary Five-Year Comparison of Selected Financial Data Adjusted for the Effects of Changing Prices

	1979	1978	1977	1976	1975
Operating revenues in millions of average 1979 dollars	\$45,408	\$45,630	\$43,657	\$41,795	\$39,001
Cash dividends declared per common share:					
at historical cost	\$5.00	\$4.60	\$4.20	\$3.80	\$3.40
in average 1979 dollars	\$5.00	\$5.12	\$5.03	\$4.85	\$4.59
Market price per common share at year end:					
at historical cost	\$52.13	\$60.50	\$60.50	\$63.50	\$50.88
in average 1979 dollars	\$49.10	\$64.85	\$70.71	\$79.24	\$66.54
Average CPI-U	217.5*	195.4	181.5	170.5	161.2

*Estimated

Report of Independent Certified Public Accountants

*To the Share Owners of
American Telephone and Telegraph Company:*

We have examined the consolidated balance sheets of American Telephone and Telegraph Company and its subsidiaries as of December 31, 1979 and 1978, and the related consolidated statements of income and reinvested earnings and sources of funds supporting construction activity for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The financial statements of two telephone subsidiaries and of Western Electric Company, Incorporated, the Company's principal unconsolidated subsidiary, were examined by other auditors; such statements reflect net income constituting approximately 27% and 26% of consolidated net income for 1979 and 1978, respectively. The reports of the other auditors have been furnished to us and our opinion expressed herein, insofar as it relates to amounts included for subsidiaries examined by them, is based solely upon such reports.

As described in Note (E), the Federal Communications Commission has ordered an inquiry to determine whether the Bell System's past interstate earnings exceeded the rate of return range approved in February

1976. In our report dated February 8, 1979, our opinion on the 1978 consolidated financial statements of the Company was unqualified; however, in view of the Federal Communications Commission inquiry referred to above, our present opinion on the 1978 consolidated financial statements, as presented herein, is different from that expressed in our previous report.

In our opinion, based upon our examinations and the reports of other auditors and subject to the effects, if any, on the consolidated financial statements of the final outcome of the Federal Communications Commission inquiry discussed in the preceding paragraph, the financial statements referred to above present fairly the consolidated financial position of American Telephone and Telegraph Company and its subsidiaries at December 31, 1979 and 1978, and the consolidated results of their operations and consolidated sources of funds supporting their construction activity for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Coopers & Lybrand
1251 Avenue of the Americas, New York, N.Y.
February 8, 1980

OFFICERS

CHAIRMAN OF THE BOARD
Charles L. Brown

PRESIDENT
William M. Ellinghaus

VICE CHAIRMAN OF THE BOARD
AND CHIEF FINANCIAL OFFICER
William S. Cashel, Jr.

VICE CHAIRMAN OF THE BOARD
James E. Olson

EXECUTIVE VICE PRESIDENTS
Thomas E. Bolger
Kenneth J. Whalen
Richard R. Hough
Charles E. Hugel

VICE PRESIDENT
AND GENERAL COUNSEL
Howard J. Trienens

VICE PRESIDENTS
Alvin von Auw
Rex R. Reed
Jack A. Baird
James R. Billingsley
John G. Fox
H. Weston Clarke, Jr.
Edward M. Block
William G. Sharwell
John L. Segall
Walter B. Kelley
Donald E. Guinn
Robert W. Kleinert
Robert E. Allen
Archie J. McGill
John L. Clendenin
Rocco J. Marano

VICE PRESIDENT
AND COMPTROLLER
Robert N. Flint

VICE PRESIDENT
AND TREASURER
Virginia A. Dwyer

SECRETARY
Frank A. Hutson, Jr.

BOARD OF DIRECTORS

William M. Batten
Chairman, New York Stock Exchange, Inc.

Charles L. Brown
Chairman of the Board

Edward W. Carter
Chairman of the Board,
Carter Hawley Hale Stores, Inc.
(department stores)

William S. Cashel, Jr.
Vice Chairman of the Board
and Chief Financial Officer

Catherine B. Cleary
Director and former Chairman
of the Board,
First Wisconsin Trust Company

Archie K. Davis
Director and Member of the Executive
Committees, Wachovia Corporation and
Wachovia Bank and Trust Company, N.A.

John D. deButts
Former Chairman of the Board

William M. Ellinghaus
President

James H. Evans
Chairman, Union Pacific Corporation

Peter E. Haas
President, Levi Strauss & Company
(apparel manufacturer)

Edward B. Hanify
Partner, Ropes & Gray (law firm)

William A. Hewitt
Chairman, Deere & Company
(farm and industrial tractors
and equipment)

Jerome H. Holland
Director of various corporations

Belton K. Johnson
Owner, Chaparrosa Ranch

*Juanita M. Kreps
Former Secretary of Commerce

Donald S. MacNaughton
Chairman of the Board,
Hospital Corporation of America

William J. McGill
President, Columbia University

J. Irwin Miller
Chairman of the Executive
and Finance Committee,
Cummins Engine Company, Inc.

James E. Olson
Vice Chairman of the Board

Donald S. Perkins
Chairman of the Board,
Jewel Companies, Inc.
(diversified retailer)

Rawleigh Warner, Jr.
Chairman of the Board,
Mobil Corporation

COMMITTEES

Audit Committee meets with management to consider the adequacy of internal controls and internal auditing activities, the objectivity of financial reporting and the scope of activities of the independent auditors and their report thereon. Each year the Committee appoints independent auditors subject to share owner ratification.

- Rawleigh Warner, Jr., chairman, Archie K. Davis, James H. Evans, William A. Hewitt, Jerome H. Holland

Compensation Committee approves the compensation of individuals at the level of Assistant Vice President and makes recommendations to the Board with respect to compensation of Directors and of officers at the level of Vice President and above.

- William M. Batten, chairman, Edward W. Carter, Edward B. Hanify, Belton K. Johnson, Donald S. MacNaughton

Corporate Public Policy Committee examines Company policy on major public issues and provides guidance to management on these issues.

- Donald S. MacNaughton, chairman, Catherine B. Cleary, John D. deButts, James H. Evans, Peter E. Haas, Jerome H. Holland, Belton K. Johnson, William J. McGill, Donald S. Perkins

Committee on Directors advises the Board on matters concerning directorship practices and the selection of candidates as nominees for election as Directors.

- J. Irwin Miller, chairman, William M. Batten, Edward W. Carter, James H. Evans, Edward B. Hanify, William A. Hewitt

Committee on Employee Benefits reviews the administration of assets, auditing and actuarial matters involving the Company's pension, benefit and employee savings plans and all material changes in the plans prior to their presentation to the Board for approval.

- William A. Hewitt, chairman, William S. Cashel, Jr., Archie K. Davis, Peter E. Haas, Jerome H. Holland, William J. McGill, James E. Olson

Executive Committee has authority to act for the Board on most matters during the intervals between Board meetings.

- Charles L. Brown, chairman, William M. Batten, William M. Ellinghaus, James H. Evans, Jerome H. Holland, J. Irwin Miller, Rawleigh Warner, Jr.

Finance Committee reviews the Company's financial policies and condition and authorizes investments in the associated Bell System companies.

- William S. Cashel, Jr., chairman, Edward W. Carter, Catherine B. Cleary, Archie K. Davis, John D. deButts, J. Irwin Miller, Donald S. Perkins, Rawleigh Warner, Jr.

*effective February 20, 1980



American Telephone and Telegraph Company
195 Broadway, New York, N.Y. 10007